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**BEFORE THE  
DEPARTMENT OF TRANSPORTATION  
WASHINGTON, D.C.**

**COMPUTER RESERVATIONS SYSTEM  
(CRS) REGULATIONS**

**Supplemental Advance Notice of Proposed  
Rulemaking**

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)  
) **Docket OST-97-2881 - 168**  
) **Docket OST-97-3014 - 37**  
) **Docket OST-98-4775 - 82**  
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**REPLY COMMENTS OF ORBITZ, L.L.C.**

Communications with respect to this document should be sent to:

Gary Doernhoefer, Esq.  
General Counsel  
ORBITZ, L.L.C.  
200 S. Wacker Drive  
Chicago, IL 60606  
(312) 632-1500  
(312) 632-1592 (fax)

Frank J. Costello, Esq.  
Jol A. Silversmith, Esq.  
Paul E. Schoellhamer,  
Director of Government Affairs  
ZUCKERT, SCOUTT &  
RASENBERGER, L.L.P.  
888 Seventeenth Street, N.W.  
Washington, D.C. 20006-3309  
(202) 298-8660  
(202) 342-0683 (fax)

fjcostello@zsrlaw.com  
jasilversmith@zsrlaw.com  
peschoellhamer@zsrlaw.com

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**REPLY COMMENTS OF ORBITZ, L.L.C.**

Orbitz, L.L.C. submits these reply comments in response to comments filed by other interested parties concerning the Department's Supplemental Advance Notice of Proposed Rulemaking. The comments the Department has received cover a wide range of concerns. Orbitz's positions as to many of these issues already have been set out in its initial comments of September 22, and will not be repeated here unnecessarily. These reply comments instead will focus on the most serious misunderstandings and misrepresentations about Orbitz, as well as on general concerns as to whether and how the Department should regulate CRSs and the Internet.

Attached to these reply comments are statements prepared by four economists in regard to the competition and other policy issues raised in the initial comments of other parties. Exhibit A is the Statement of Daniel M. Kasper, Managing Director of the Cambridge, Massachusetts office of LECG, a financial and economic analysis firm. Exhibit B is the Joint Statement of

Steven A. Morrison, Clifford Winston, and Robert E. Litan. Mr. Morrison is a Professor of Economics at Northeastern University. Mr. Winston is a Senior Fellow of the Economic Studies Program at the Brookings Institution. Mr. Litan is Vice President and Director of the Economic Studies Program as well as the Cabot Family Chair in Economics at the Brookings Institution

**I. The Department has the authority to regulate all CRSs based on their contracts with travel agents, and should clarify that this is the key basis of the CRS Rules.**

Almost every party that has filed comments as to the issue agrees that the Department has the statutory authority to regulate every CRS which currently operates in the United States. But there is considerable discord as to the ultimate basis of the Department's authority. Some parties take the position that because every CRS is at least still marketed by an airline, the Department need not pursue the question of its authority any farther than 14 C.F.R. § 255.2, which empowers it to regulate CRSs owned, controlled, operated, or marketed by an airline. See, e.g., Comments of Delta Air Lines, at 12-13. But Sabre in recent months has questioned – off the public record – whether it is still subject to the CRS Rules, and it is also not impossible that in the near future Sabre or another CRS would cease to have even a marketing relationship with an airline. The Department therefore should revise the CRS Rules to clarify the key basis of its authority, as well as to ensure that all CRSs will be covered by the CRS Rules even if they are not owned, controlled, operated, or marketed by an airline. In particular, the Department should make certain that the applicability of the CRS Rules to Sabre (the largest CRS in the world) does not hang solely on the narrow factual issue of whether Sabre continues to be marketed by an airline.

The ultimate foundation for the Department's concerns about anti-competitive influences of CRSs – and for its authority to regulate CRSs – are the contracts that CRSs enter into with travel agents. These contracts have bestowed upon the CRSs not only unfair dominance over



agents, but also market power over the distribution of airline tickets, regardless of each CRS's airline ties (if any). Agents lack any ongoing market choice among CRSs. Their contracts lock them in to long terms – often effectively perpetual terms, because of overlapping or “shingled” agreements. In addition, although agents cannot explicitly be prohibited from using another CRS, contract terms typically make such an alternative impractical for most agents, and these contract terms are backed up by the threat of enormous liquidated damages. The CRSs' market power over the airlines inevitably follows. Air transportation is a narrow-margin business, and no airline can afford not to reach the agents locked-in to each CRS, and thus their customers.

Section 411 of the Federal Aviation Act, today codified at 49 U.S.C. § 41712, authorizes the Department to investigate and put a stop to unfair or deceptive practices and unfair methods of competition in air transportation or the sale of air transportation. The terms of the contracts between CRSs and travel agents, and the effects thereof that echo throughout air transportation, justify the regulation of any CRS that enters into contracts with agents, regardless of ownership. CRSs “are the essential tool ... on which such agents rely in the sale of such transportation.”

Comments of Amadeus, at 11. Each CRS could, unless restricted by rules, increase its profits by distorting competition, such as by selling bias to the highest bidder. Neither airlines nor agents have sufficient leverage to stop the exercise of CRS market power. See, e.g., Comments of Qantas Airways, at 2. Most importantly, and in contrast to Internet users, CRS users are under contract and cannot switch to another provider if unsatisfied. Nor could an airline that was competitively disadvantaged by bias in a CRS credibly attempt to remedy the situation by threatening to withdraw its inventory unless the bias were corrected. The contractual lock that each CRS has on its agents stymies any competitive remedy. In sum, the CRS Rules should not only be renewed, but revised to make clear the basis of their authority: the incentive and ability

of all CRSs to use the market power based on agent contracts to distort airline ticket distribution. The CRS Rules should apply to any CRS that enters into contracts with travel agents.

However, the Department also should be alert to the fact that although it has the statutory authority to regulate airline ticket distribution, it should not intervene in the market absent a clear empirical justification for regulation. The CAB's finding of CRS market power has, since the 1983-84 rulemaking, been proven to be entirely justified. But as the Department knows well, a precondition for regulation of an unfair method of competition under section 411, then as now, is that the practice in question must be determined to violate antitrust laws or antitrust principles. See Department of Transportation, Computer Reservations System (CRS) Regulations, Supplemental Advance Notice of Proposed Rulemaking, 65 Fed. Reg. 45551, 45554 (July 24, 2000). The concerns that have been expressed about Orbitz, in contrast, largely are wild speculations about what might happen in the future – and often are based at best on incomplete or inaccurate information, and not on any acts that actually have occurred. Orbitz has no sales, much less market power. It should and must be allowed to demonstrate not only that it poses no threat to consumers and competition, but that it in fact will drive market forces that can help resolve many of the gross distortions that have plagued airline ticket distribution for the past twenty years.

**II. The Department should not broadly apply the existing CRS Rules to the Internet, and certainly should not apply the CRS Rules to some sites and not others.**

Entrenched incumbents such as Sabre/Travelocity and Microsoft/Expedia have recommended that the Department extend the full range of CRS Rules to some Internet travel websites and not to others, attempting either to exempt their own sites from any regulation or to disadvantage online competitors for whom there is no empirical justification for regulation.

Most commonly, the entrenched incumbents have asserted that the Department should regulate only those websites that have airline ownership, and not “independent” websites (meaning simply that they are independent of airline ownership).

But that is a distinction without significance. Just as for CRSs, as explained in Orbitz’s comments at pp. 74-76, ownership should not be the factor that determines the scope of the rules (if any) adopted by the Department for websites. Before regulating any website with respect to unfair competitive practices, the Department should ask whether it has the ability and incentive to exercise market power. The Internet should be as close to a system of perfect free choice as any system ever devised. Any user can switch from one website to another at the click of a mouse. Indeed, according to Gomez Advisors, an Internet research firm, more than 60% of leisure travelers who buy airline tickets online visit at least two sites before making a purchase, and nearly 45% visit four or more sites. See, e.g., Laura Bly, [Air Fare Search Sites Are Worth a Look](#), Los Angeles Times, October 15, 2000, at L1.

Travelocity and Expedia, by entering the channel first and leveraging the power of their parent corporations in related industries, admittedly did acquire and today exercise market dominance over airline ticket distribution on the Internet. But if Orbitz and other new entrants are allowed the opportunity to challenge these duopolists, market forces will be able to re-enter and re-balance competition in this distribution channel. Such an outcome would benefit not just all of the other players in the distribution of airline tickets, but consumers as well.

In contrast, the entrenched incumbents’ proposals to extend the CRS Rules in various selective ways amount to requests that the Department regulate the Internet illogically, in order to protect the incumbents’ parochial interests, instead of those of consumers and competition.

- Sabre initially asked the Department to extend the CRS Rules to all websites that display flights by multiple airlines, but noted that it would be content if the CRS Rules were extended only to sites owned or marketed by airlines. See Comments of Sabre, at 6. Sabre's Internet arm, Travelocity,<sup>1</sup> might in the latter case choose to comply with the CRS Rules, but it would be under no requirement to abide by them, even though other websites would. Given Sabre's recent indecisiveness as to whether it is itself covered by the CRS Rules,<sup>2</sup> the Department should recognize that the coverage of its rules should not be left as an open question, subject to interpretation by the regulated parties.<sup>3</sup>
- Expedia has called upon the Department to extend the CRS Rules to all ticket distribution channels with airline ownership, but not to "independent" websites, such as Expedia. Expedia claims that only airline-owned sites have the incentive and ability to distort airline competition. See Comments of Expedia, at 4. But Microsoft can and has used its Internet arm to do precisely that, selling preferred

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<sup>1</sup> In its comments, Travelocity has tried to downplay the fact that it is approximately 70% owned by Sabre. See Comments of Travelocity, at 2. But Sabre itself identifies Travelocity as an "affiliated company" – see Comments of Sabre, at 6 – and Travelocity's home page states that it is "A Sabre Company" (<http://www.travelocity.com>).

<sup>2</sup> Sabre's support today for the regulation of the distribution of airline tickets online also is a nearly total and self-interested reversal of its position in 1998 when it stated unequivocally that Sabre "strongly believes that CRSs should be permitted and encouraged to compete with each other to have access to distribute [Internet] fares. As demand for wider distribution of the fares increases, CRSs will respond to those market pressures with products and features that make it worthwhile for carriers to make the fares more widely available." Reply Comments of Sabre, at 10 (Feb. 3, 1998).

<sup>3</sup> If the Department were to regulate only airline-owned websites, another question that would be left open to debate is how far along the chain of ownership the Department would reach in deciding if a site was "airline-owned" – i.e., would TRIP.com, a subsidiary of Galileo, be considered to be an "airline-owned" website and subject to government regulation, on the grounds that United Airlines and Swissair still are considered to be system owners of Galileo?

carrier status to the highest bidder and shifting market share.<sup>4</sup> Further, Expedia has an exclusive arrangement with the third and fourth largest Internet portals, MSN and Microsoft, and has a primary business objective to increase the equity value of these portals by generating “eyeballs” for them. Indeed, for Expedia to trumpet that it is “independent” when Expedia is 75% owned by Microsoft – one of the most dominant, assertive, and controversial corporations in the world – is a gross distortion of the term’s meaning. Similarly, Expedia’s implicit suggestion that its owner (Microsoft) should be understood as having more pro-competitive motives and modes of operation than Orbitz’s owners is astonishing in light of the revelations in recent litigation against Microsoft.

- American Express similarly calls upon the Department to extend the CRS Rules to websites with airline ownership, but not “independent” sites like Travelocity and Expedia – and AmEx. But AmEx’s description of Travelocity and Expedia as “honest brokers” for consumers – see Comments of American Express, at 4 – strains all credulity. Moreover, the reason for its advocacy of selective regulation is transparent. AmEx offers an air transportation booking engine and other travel services on its website, which it no doubt would prefer to remain unregulated.<sup>5</sup>

Travelocity has adopted a slightly different tactic: it has called on the Department to extend most if not all of the CRS Rules to all websites, including those of individual airlines that

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<sup>4</sup> Expedia, much like Sabre, has reversed its previous position that “[t]here is no empirical evidence that current or likely future uses of Internet travel services present the possibility of anticompetitive or deceptive effects in the air travel industry. Moreover, the structural characteristics of the Internet make anticompetitive or deceptive behavior at once undesirable and impractical for Internet travel service owners.” Comments of Microsoft, at 2 (Dec. 9, 1997).

<sup>5</sup> In addition, AmEx’s travel booking engine is “powered” by GetThere, Inc., which is now owned by Sabre.

accept interline bookings. See Comments of Travelocity, at 16-17. Travelocity is the first party to have called for such an expansion of the display bias and other rules,<sup>6</sup> a shift which clearly is overbroad and unjustified by any empirical data. Travelocity apparently expects that such a rule would disadvantage airline sites to its advantage, as many sites might cease offering consumers information about interline opportunities. This would unnecessarily lessen competition offered by airline sites; as has been explained by many parties and most succinctly stated by British Airways: “a passenger accessing a web site identified to an individual carrier or carrier alliance well understands that flights on the proprietor carrier(s) will receive top billing.” Comments of British Airways, at 5. Further, Travelocity’s proposal apparently would require the Department to regulate not just travel sites but media sites such as those of ABC News and the Washington Post, which publish lists of the best fares offered by multiple airlines. The Department would thus for the first time regulate discourse that is at the heart of the First Amendment. As Orbitz explained in its comments, at p. 67, the Department should be very wary of crossing the Rubicon of regulating Internet content.

In sum, entrenched incumbents have asked the Department to protect competitors, instead of competition, in online airline ticket distribution. These requests are directly at odds with the Department’s charge and mission under Section 411.<sup>7</sup> “[I]ntervention in the CRS market to benefit a particular competitor is wholly inconsistent with our effort in the proposed rules to give maximum flexibility to CRS industry participants to respond to the needs in the market.” See

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<sup>6</sup> See also Comments of Consumers Union, at 6 (CRS Rules should extend to all sellers of airline tickets in all media, including airline ticketing personnel). Cf. Comments of Expedia, at 7-8 (CRS Rules should extend to all airline-owned sellers of tickets for multiple airlines in all media, including airline-owned toll-free numbers).

<sup>7</sup> They are also contrary to the purpose of the antitrust laws. See Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 97 (1977), citing Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962) (“[t]he antitrust laws ... were enacted for ‘the protection of competition not competitors’”) (emphasis in original).

Civil Aeronautics Board, Carrier-Owned Computer Reservations Systems, Notice of Proposed Rulemaking, 49 Fed. Reg. 11644, 11669 (Mar. 27, 1984). The Department should not regulate the Internet prematurely in the absence of any compelling proof that Orbitz or other Internet new entrants are a present danger to competition – especially in light of the evidence that they will in fact act to correct many of the lingering imperfections in the market. The Department certainly should not adopt regulations that would protect incumbents from having to evolve and innovate or that would discriminate among online agencies.

**III. The Department should be wary of extending the display bias rule to the Internet, and certainly should not apply the display bias rule to some sites and not others. At most, it should require websites to disclose any arrangements to shift market share.**

American Airlines, Lufthansa German Airlines, Midwest Express Airlines, Northwest Airlines, OAG Worldwide, and Worldspan have called on the Department to require websites that display the flights of multiple airlines to disclose to consumers if their displays are biased in favor of specific airlines, and/or to require websites that claim to be objective to comply with the relevant sections of the CRS Rules. See, e.g., Comments of Worldspan, at 9-10. Such a requirement would have no effect on Orbitz, because Orbitz displays will go well beyond mere compliance with Part 255.4. Orbitz offers a written guarantee in its contracts with airlines as well as in its articles of incorporation that it will provide unbiased displays and the same CRS booking fee offsets for every airline – big or small, new or old, investor in Orbitz or not.<sup>8</sup> Orbitz is absolutely obligated to be unbiased. No other website that Orbitz knows of has that obligation. Travelocity does not. Expedia does not.

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<sup>8</sup> The American Automobile Association claims that the “Orbitz business model ... permits only a few airlines to participate, [and] discriminates against those that are not involved through investment in this venture.” See Comments of the American Automobile Association, at 1. AAA is mistaken. All airlines have been invited to

Travelocity and Expedia both claim that they do not re-order data provided to them by their respective CRSs. But there is mounting evidence that their displays are biased and may not be not consistent with Part 255.4. See Comments of Midwest Express Airlines, at 11-13 (Expedia displays); Northwest Says Travelocity Site Guilty of Display Bias, Aviation Daily, at 3 (July 31, 2000) (Travelocity displays); “Lowest fares” online are all over the map, Consumer Reports, at 8 (Oct. 2000) (“[t]he unusual spread of the online offerings raises questions of ‘display bias’”); Is Your Web Site Biased?, Consumer Reports Travel Letter, at 2 (Oct. 2000) (Expedia displays omit Spirit Airlines; Northwest Airlines Vice President claims that a travel website’s “preferred carrier” is listed first in the event of a tie); Testimony of Jeffrey G. Katz, Chairman, President, and CEO, Orbitz, before the Committee on Commerce, Science and Transportation, U.S. Senate, July 20, 2000, at Exhibit B (examples of Travelocity displays that omit options available through Sabre).

What is known with certainty at this time is that Travelocity and Expedia, the largest on-line agencies, seek and receive payments from a number of airlines to modify what they present on their screens in such a manner as to “shift market share” from what it would have been had the modification not been made, and that as a result of these screen modifications market share is in fact shifted. Further, airlines have cited instances in which flights or fares that should have shown up in a website list thereof did not appear at all, even though a simultaneous CRS search found that seats were available at the fare in question. See Testimony of Jeffrey G. Katz, Exhibit B. These observations seem to be borne out by the Consumer Reports analysis of travel websites. What is more difficult to determine from outside of Travelocity and Expedia is

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become Orbitz associates, and to receive exactly the same benefits, on exactly the same terms, as investor airlines will for their sales through Orbitz.



whether these market share-shifting modifications have been implemented in ways that would be prohibited by Part 255.4, if that regulation applied to the Internet, or whether the modifications have been implemented using solely techniques that bias displays without using forms of bias that are barred by the rule.

All this leads to a key fact about display bias: bias is not a simple binary question. Bias is not a single commodity that is either present or not present. There are many levels and kinds of bias – many of which are not prohibited by the CRS Rules. If someone charges that Travelocity, for example, is biased, and Travelocity replies that its practices would not violate the display bias rule if it applied to the Internet, both may be correct. The problem is that many of the players in the bias debate have assumed a meaning for the term “bias” that is not the same as the meaning assumed by other parties. The possible elements of bias should be more clearly spelled out:

- There is the most overt form of bias, which occurs when a system deletes, or gives worse display to, a particular flight, or a particular airline’s flights, or engages in similar direct action against a specific target. This is prohibited by Part 255.4.
- There is automated bias based on carrier-specific factors, which occurs when a system’s search algorithm by default weighs the flights of one airline somewhat better, or somewhat worse, than the flights of another airline. This is prohibited by Part 255.4, and is the form of bias most often mentioned in conjunction with the CRS Rules.

- There is the bias based on non-carrier-specific factors. A system can use almost any search algorithm except for one containing one or more carrier-specific factors, weighing factors such as elapsed time, the amount of time separating the requested departure time from the actual departure time (“displacement time”), connections, alternative airports, etc. Part 255 requires that whatever algorithm a system selects, it must use it consistently and without discrimination – but the algorithm can, on average, benefit one airline and disadvantage another. For example, if a system uses an algorithm that puts more weight on displacement time and less on elapsed time, an airline whose route structure is characterized by unusually low circuities, but which offers fewer frequencies, will get less favorable display and lose passengers relative to an airline that has higher average circuities and more frequencies. In this example, a system can “shift market share” from one airline to another, but still comply with Part 255. And because there are a virtually infinite number of ways to construct a search algorithm, there are a virtually infinite number of means available to achieve whatever overall effect on passenger traffic a system desires.
- There is bias borne of technological limitations, which not only is tolerated but specifically sanctioned by Part 255. A system can advantage a particular airline, or type of airline, simply by having a certain type of technological limitation. For example, CRSs typically have relatively limited search capabilities. In order to construct a much smaller universe of flights and fares to be searched, the CRSs therefore pre-select the hubs which will be used to construct connecting flights,

using only a small subset of the total number of possible connection routings. See Comments of Orbitz, at 21-22. On average these “connection tables” advantage larger airlines operating from larger hubs, and disadvantage smaller hubs or less trafficked, but perfectly feasible, connection opportunities. Another technological limitation, more common in the past, was that CRSs made “last seat availability” technology available to the host airline but not to other airlines; many questioned whether the CRSs built the capability to offer it to other airlines as quickly as they could have. The same could be said for many other enhancements CRSs have added over the years, such as selecting an advanced seat assignment, pre-printing a boarding pass, enabling a seat assignment to follow a changed itinerary, etc. These are all ways that systems can and have, at various times, used technological limitations to influence whether passengers make use of one airline or another.

- Today’s online agency websites have bias opportunities and means that the CRSs did not. The most important is seat availability. CRSs show flights and fares, whether or not seats are available.<sup>9</sup> A website only shows flights and fares if it believes that the requested number of seats are available at that fare. Therefore, an online agency that mistakenly believes that no seat is available on a certain flight and/or at a certain fare does not display it to the consumer at all. Online agencies often do not show options to consumers which their parent CRS does, and for which the seats requested are available. This typically happens because

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<sup>9</sup> CRSs show in separate data columns whether seats are available or not in each “bucket,” or grouping of fares, for each flight.

these sites use relatively stale seat availability data, particularly in the early steps of the search algorithm. They do so because fresher data, particularly with respect to the relatively large number of flights searched in the early steps of the algorithm, requires either a higher cost in communications, or a large investment in new technology, or both. Moreover, an online agency could make better seat availability technology, by providing fresher data earlier in the search process, available to one airline but not to another. This would provide the former carrier with a major advantage: the result on average would be far better displays for that carrier, and a significant shift in passenger traffic to that carrier. Yet the system would not have altered its algorithm, and could be entirely compliant with Part 255.4 display bias standards.

- There is bias that does not literally reorder or eliminate any flights or fares, but uses the display screen to swing market share in other ways. Some of the existing online agencies are particularly adept at this form of bias. For example, they sell “preferred airline” status to the highest bidder and go to great lengths to guide consumers to displays highly biased in favor of those airlines. These sites also put advertisements and other promotions on the screen while the customer is attempting to select a flight.<sup>10</sup> There is no question that they can and do use the screen on which flight and fare displays appear to swing market share, quite apart from the question of what they do with the actual displays of flights and fares.

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<sup>10</sup> Advertisements or in-screen promotions are distinct from what Travelocity, for example, does to “shift market share.” Travelocity offers airlines two distinct propositions. One is to buy advertising on Travelocity. Another is to buy the shifting of market share to a specified share. An airline typically can purchase one, or the other, or both.

All these bias techniques make it more likely that a passenger will end up on a system's favored airline, and less likely that that he will end up on any other airline. They are all bias and have the effect of bias, but only a few are prohibited with respect to CRSs by the existing CRS Rules, and none are prohibited with respect to online agencies. These bias techniques can move significant revenue from one airline to another, and that capability has significant value which can be sold. Today the leading online agencies, Travelocity and Expedia, in fact offer for a price, through some unspecified combination of these techniques, to shift a specified amount of market share in a specific city-pair market. But these bias techniques could be applied in other ways as well. For example, a CRS (particularly if no longer owned or marketed by one or more airlines) could sell its ability to bias its search algorithm for all markets. It would have to do so in a way that did not involve a carrier specific factor; the CRS might sell (or more likely, rent) its decision of whether to weigh elapsed time more heavily, or displacement time more heavily, or penalize multiple connection flights more. But so long as it did so on a system-wide basis, it would comply with Part 255.4.

No system need have any of these biases. If they have them, they choose to have them. When Orbitz states that it will be comprehensive and non-biased, it does not mean simply that it will be compliant with Part 255.4 (if that rule applied to the Internet). Orbitz means that, plus:

- that Orbitz will use a neutrally-developed search engine, created outside of the airline industry, based solely on studies of consumer preferences;
- that Orbitz's new search engine will have the ability to search every possible flight and fare option, without pre-selecting any connections out of the search, as

well as the vastly greater computing power necessary to fully utilize that search engine's ability to search all flight and fare possibilities;

- that Orbitz has arranged for ITA Software and Worldspan to construct a new seat availability search capability that will vastly improve the quality and freshness of seat availability data, and thus greatly reduce the possibility of any flight or fare being dropped from a search in an erroneous belief that no seats are available; and
- that no advertising, preferred airline enticements, or other devices will be used on any Orbitz screen that is on the path of a customer searching his or her flight and fare options and making a booking.

That is what a system without bias can, should, and will look like, and that is also what will most often be the reason that Orbitz will find a better fare or a better flight for consumers.

What can and should the Department do about display bias in CRSs and online agency websites?

The Department could apply Part 255.4 to all online agency websites. If it did so, there certainly would be no basis to discriminate among online agencies (i.e., the rule should apply to all online agency websites without regard to who owns or invests in them). This is a solution that would have no effect on Orbitz, because Orbitz already far exceeds the requirements of the display bias rule. Orbitz would therefore not object to an extension of the existing display bias rules to all online agency sites.<sup>11</sup> But the Department also needs to consider that in so doing it

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<sup>11</sup> Orbitz, as stated elsewhere, does not believe such a rule is necessary nor is the most effective means by which to limit bias on the Internet: competition from new technologies and new entrants is. Nor would the modest effect of applying Part 255.4 to online agency sites produce benefits commensurate to the issues raised by moving to regulate Internet content. For these reasons, Orbitz has urged the Department to be wary of moving into this area. However,

would fail to address many of the most serious forms of bias on these sites – and if the Department did try to address in a revised rule many or all of these other forms of bias, it would find itself promulgating and administering a rule of enormous complexity.

The Department also could, instead of expanding the existing prohibition against one kind of display bias to the Internet, simply enact a requirement that if an online agency is biased, that fact must be disclosed on its website to consumers. This requirement has the advantage of placing a less-heavy hand of regulation on Internet content, but it does retain all the problems of defining bias. As above, if the current definition of bias is used (i.e., the use of carrier specific factors in a search algorithm), existing sites will be able to continue to shift market share without disclosing their bias. But if more types of bias were included in the definition of what online agencies must disclose, the Department again would find itself promulgating and administering a very complex rule.

The Department has two other options, however, that would be far more effective and far simpler to promulgate and to administer.

The first would be to allow new competition, including Orbitz, to bring competitive pressure to bear on the issue of display information quality. The most important part of Orbitz's appeal to consumers will be its comprehensive and unbiased display of flights and fares. Orbitz believes that sooner or later, other websites will have to respond to the appeal of its superior information display and will respond with improvements of their own displays. The customers of many online agencies would benefit as a result.

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if the Department chooses to take this step, and does it in a way that simply extends the Part 255.4 display bias rules to all online agencies, Orbitz would be unaffected and would have no basis to object.

The second would be to require disclosure to consumers of any arrangement by which an online agency accepts payment, in any form, to shift market share by any on-screen technique. This option would tackle the root cause of most bias on online agency sites, but would be far simpler to promulgate and to administer, because it is much easier to define payment to shift market share than to define all the possible ways in which that bias could be implemented.

**IV. The Department should not require airlines to provide Internet fares to websites and CRSs – to do so would be to stifle the last, best chance of stirring long-needed reforms of the anti-competitive practices that are common in the CRS industry, and would increase costs to consumers.**

Amadeus, American Express, the Interactive Travel Services Association, the National Business Travel Association, Sabre, Travelocity, and the United States Travel Agent Registry have called on the Department to require airlines to provide their Internet fares (as well as other internal reservations system functionality, i.e., frequent flyer access and redemption) to websites as well as CRSs, without any corresponding obligation by the websites and CRSs to reform their anti-competitive and anti-consumer practices. See, e.g., Comments of Travelocity, at 22. As recently as 1998, Sabre maintained that regulatory intervention was both unnecessary and inappropriate, and that competition should determine access to fares. See supra at p. 7, n.4. The only change since is that it has become clear that Orbitz will introduce increased competition.

With regard to this matter the Department should keep in mind what its goal should be – that is, to stimulate competition among distribution systems so that they all will provide quality service to consumers, travel agents, and airline competitors at lower costs. A regulation which compels airlines to use a distribution system without regard to its poor service quality or its high costs will work against that goal, is contrary to the public interest, and simply would be wrong, as Inspector General Kenneth M. Mead implicitly recognized in his recent reform proposals.



As Orbitz explained in its comments, at pp. 67-71, there is much to be said in favor of Mr. Mead's concept that airlines should provide their Internet fares to websites that in return offer reforms of equivalent value to those offered by Orbitz (i.e., booking fee offsets, unbiased displays, and data ownership). Mr. Mead's proposal recognizes that bargaining over access to Internet fares would create an opportunity to rein in CRS booking fees, bias, and other anti-competitive practices. Orbitz believes that, absent regulation, market forces would result in Orbitz-like agreements between individual airlines, on the one hand, and CRSs and websites, on the other hand (or at least, airlines individually would be willing to accept similar agreements, if CRSs and websites were to offer them).<sup>12</sup> And as Orbitz also explained in its comments, a rule enacting Mr. Mead's proposal as a regulation also would be inordinately complicated to administer, while the market would effectively implement the proposal without the regulatory complexity and administrative burden. The key, then, is to let competition work by bringing it to bear on long-standing anti-competitive CRS practices, and at the same time closely monitor the travel industry for the emergence of any specific anti-competitive practices.

Sabre/Travelocity and other entrenched interests, in contrast, have asked the Department to, in effect, completely disregard Mr. Mead's proposal by guaranteeing them access to airlines' Internet fares with no strings attached; with no ability for those airlines to individually bargain for fairer fees and practices; and with no limitation on the excessive fees the CRSs charge for selling those fares. Sabre suggests that applying Part 255.7, the mandatory participation rule,<sup>13</sup>

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<sup>12</sup> Indeed, "[s]everal airlines have indicated that if other sites can provide financial incentives comparable to the Orbitz rebate on CRS booking fees, they are willing to make the low fares they provide Orbitz available to other outlets." Statement of the Honorable Kenneth M. Mead, Inspector General, U.S. Department of Transportation, before the Committee on Commerce, Science and Transportation, U.S. Senate, July 20, 2000, at 21.

<sup>13</sup> Part 255.7 in essence requires airlines that are system owners to participate in all other systems at the same level that they participate in their own system.

to the Internet would allow Sabre to charge only “commercially reasonable” booking fees to online transactions. See Comments of Sabre at 19. But if that were true, then all CRS booking fees already would be “commercially reasonable,” and that is clearly not the case.

What Sabre fails to acknowledge is that Part 255.7 not only provides that system owners must participate in other systems to the same extent they participate in their own “if the other system offers commercially reasonable terms for such participation,” but goes on to state that any fee “shall be presumed commercially reasonable” if the other system owner in question charges the same fee as the system in question for the same level of participation. Because every CRS has, as a practical matter, no choice but to charge whatever Sabre charges,<sup>14</sup> the rule in effect (and quite unintentionally) has defined whatever fees Sabre charges to be “commercially reasonable,” no matter how unreasonable they may be. That is the reason that no airline has filed a proceeding concerning this issue. The effect of Part 255.7 thus has been to protect Sabre’s market power in pricing CRS services – which is precisely why it should be repealed.

That is also the reason why Sabre asserts that the “commercial reasonableness” approach has worked exceedingly well since its adoption by the Department in 1992. For Sabre, it has worked exceedingly well, which is noteworthy for a rule that was supposed to restrict Sabre’s monopoly power! And Sabre, not surprisingly, would like Part 255.7 to be extended to the few areas of ticket distribution it does not already dominate, for that same reason. The Department

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<sup>14</sup> By virtue of Sabre being by far the largest CRS, the airline system owners of other CRSs as net payors of booking fees would be worse off if their systems charged more than Sabre, offering Sabre an excuse to raise its booking fees even higher. They would also be worse off if their systems charged less than Sabre, offering those airlines even less of a partial offset to the fees each paid to Sabre. What Sabre charges as its booking fee thus in practice becomes both the ceiling and floor of what other CRSs can charge.

needs at this juncture to decide whether its role is to protect the CRS monopoly, by allowing it to extend its market power to the Internet, or to enable the reintroduction of competition.<sup>15</sup>

The consequences of Sabre/Travelocity's proposal to extend the mandatory participation rule to the Internet would be especially devastating for the most price-sensitive consumers, such as students, low-income persons, minorities and the elderly. A rule requiring airlines to sell all of their fares through every channel would, in effect, ban (or increase the price of) the low fares that the Internet has made possible.

The Department recently reached much the same conclusion with respect to the petition of Donald L. Pevsner (Docket OST-97-2061). In addition to issues related to disclosure, Mr. Pevsner specifically called for airlines to be required to offer through their telephone reservations centers any fare that they offered through their websites. This proposal presented the same issue of requiring a low fare that is sold through a low-cost channel also to be sold through a high-cost channel. The Department denied Mr. Pevsner's petition on this issue, concluding that it "would be contrary to the public interest" to require "airlines to make their Internet fares available through their reservations agents." Order 2000-10-13, at 4. The Department noted that "the pro-competitive policy directives in 49 U.S.C. § 40101 allow airlines to choose the channels for distributing their services as well as the prices and terms of sale for different channels, subject, of

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<sup>15</sup> In addition, Orbitz does not necessarily agree with Sabre's interpretation of the significance of applying Part 255.7 to the Internet. Part 255.7(a) refers to participation in a system and levels of enhancement (i.e. basic, direct connect, etc.), while Part 255.7(b) refers to the provision of flight and fare information to each system. If Part 255.7 were applied to the Internet "as is," Orbitz believes that the question of whether an airline that was a part owner of Orbitz would have to offer the same fares it made available to Orbitz to Sabre would be governed by Part 255.7(b) and not Part 255.7(a). The "commercially reasonable" language that Sabre disingenuously cites is from Part 255.7(a). But the relevant language is instead the requirement of Part 255.7(b) that each system owner "provide ... information on its airline schedules, fares, and seat availability to each other system in which it participates on the same basis...that it provides such information to the system that it owns..." (emphasis added). Orbitz believes that the phrase "on the same basis" would mean that, to be take advantage of a government mandate that a website receive the same fares that Orbitz receives, another system would have to provide airlines with the same benefits that Orbitz provides to them, and it would have to do so for all fares it receives from the airlines, just as Orbitz will.

course, to the antitrust laws that govern firms in other unregulated industries.” Id. at 4-5. The Department correctly reasoned that requiring airline reservations agents to deal with Internet fares would raise airline costs, and those costs would “ultimately [be] passed on to the consumer.” Id. at 5. The Department further reasoned that “[s]uch a requirement might also deter airlines from offering the lower fares at all.” Id. at 5. Finally, the Department concludes that selling Internet fares over a low-cost channel (the airline website) but not a high-cost channel (the telephone reservations center) does not constitute “an unfair or deceptive practice within the meaning of 49 U.S.C. § 41712.” Id. at 5.

Internet fares typically are distressed goods, tickets for seats on flights that operate at inconvenient times or on less popular routes, which otherwise would go unsold. They would be uneconomic commodities if they had to be sold through more expensive channels of airline ticket distribution, such as CRSs and websites that did not offer airlines any commercial benefits in return for access to the fares. Sabre/Travelocity’s goal is not to expand the availability of fares, but instead to stop airlines from skirting the overpriced CRS monopoly and offering a small number of low fares directly to the public, such as through the lower cost sales channel that Orbitz will make available.

Moreover, the entire premise of the argument that all CRSs and websites should be given free access to Internet fares – that they otherwise would be at a serious competitive disadvantage – is undercut by a recent study by the International Data Corporation. The study assumes that Orbitz will enter the airline ticket distribution market, and apparently also assumes that existing CRSs and websites will be unwilling to offer airlines reforms of their prices and practices in return for access to Internet fares. But IDC still finds that the percentage of airline tickets purchased online through independent travel agents will increase every year from 2001-04, while

the percentage purchased through airline-affiliated sites will decrease in that period. See IDC Expects Travel Agencies to Outsell Airlines on the Internet, IDC News Release, Sept. 18, 2000. Indeed, Orbitz anticipates vigorous and ongoing competition from Travelocity, Expedia, and other sites. Given the five-year head start of its competitors – and the long-term lock they have on exclusive deals with the major Internet portals – Orbitz recognizes that it has many obstacles to overcome to even reach its goal of becoming the 3rd largest online travel agency.

**V. The Department should not prohibit the use of the Orbitz most favored nation clause that pro-competitively expands the availability of fares to consumers.**

The American Antitrust Institute, Expedia, Galileo, the Interactive Travel Services Association, Sabre, and Travelocity express concern about the “most favored nation” (“MFN”) clause in the agreements between Orbitz and participating airlines.<sup>16</sup> They allege that Orbitz’s MFN clause is no different than the Sabre MFN clause which the Department determined in the 1996-97 parity clause proceeding, Docket OST-96-1145, to have been detrimental to competition with no corresponding benefit for consumers. See, e.g., Comments of Sabre, at 10-11.<sup>17</sup>

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<sup>16</sup> ITSA and Travelocity in their comments at best misapprehend (and at worst misrepresent) the scope of the MFN clause in the agreements between Orbitz and participating airlines: i.e., both claim it would reach all consolidator fares, and fares offered through targeted e-mail. See Comments of ITSA, at 4; Comments of Travelocity, at 11.

In fact, the MFN clause only reaches those consolidator fares that are offered online to the general public in a non-opaque manner, and explicitly excludes fares offered through targeted e-mail. The MFN clause also does not reach all other “unpublished” fares, including corporate, government, membership club, affinity program, or opaque fares; and fares bundled with vacation packages or non-travel products. The Department should consult the authoritative text of the agreements between Orbitz and participating airlines, which has been provided on a confidential basis, and not potentially inaccurate summaries, excerpts, or characterizations from other parties.

In addition, nothing in the MFN clause prevents airlines from offering special fares to a narrow audience exclusively through traditional travel agents, which will for the foreseeable future continue to sell the vast majority of tickets for air transportation. Indeed, airlines reasonably can be expected to base their pricing strategies on the channels that will be selling 98-99% of all tickets, rather than on the MFN clause of one online agency selling 1-2% of all tickets. An MFN agreement with a channel that accounts for a small share of a company’s sales does not reduce its incentive to compete on price in all other sales channels. See, e.g., Barry C. Harris and David A. Argue, Most Favored Nation Clauses in Health Insurance, Economists Ink (Spring 1999) (<http://www.ei.com/publications/1999/spring3.htm>).

<sup>17</sup> Ironically, ITSA apparently argues that Orbitz – and only Orbitz specifically – should be prohibited from making use of a MFN clause. See Comments of ITSA, at 4-5. Yet Sabre, one of ITSA’s most dominant members, not only

Orbitz's MFN clause is entirely different from the clause that was at issue in the parity proceeding. Sabre, the largest CRS in the world, was found to have used its market power to force airlines to purchase services that they did not want (i.e., higher levels of participation in Sabre). Airlines had no real choice but to comply with Sabre's demands, because even those airlines not required to participate in Sabre by the mandatory participation rule as a practical matter had to participate in order to reach those agents (and thus the customers of those agents) locked-in to long-term contracts with Sabre. Sabre's MFN clause was a pure exercise of pre-existing market power, and the Department was correct to find that it had been enacted for the purpose of extorting payments from airlines, with no corresponding benefits of any kind to the airlines or to consumers. See Department of Transportation, Computer Reservations System (CRS) Regulations, Final Rule, 62 Fed. Reg. 59784, 59794 (Nov. 5, 1997).

In contrast, the Orbitz MFN clause is very different. Most importantly, the Orbitz MFN clause was adopted by an entity with no market power. Moreover, the Orbitz MFN clause is simply an offer, not a non-negotiable demand, as Sabre's was. The Orbitz offer to any airline is basically this: In return for a commitment from Orbitz that it will give the airline 60% of whatever rebate Orbitz receives from the CRS for bookings on that airline (an indirect offset to the CRS booking fee that no other website has been willing to match), Orbitz asks the airline to offer through Orbitz fares that the airline chooses to offer to the general public elsewhere. Whether each individual airline chooses to enter into that arrangement is entirely voluntary. If it chooses not to, it will still receive completely unbiased display and booking capability through Orbitz, without having to pay extra to not be biased against. If it does choose to enter into that

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has asserted that its own agreements with airlines incorporate similar clauses, but is now threatening to raise its fees dramatically (by more than twice the amount it would otherwise demand) unless airlines offer their Internet fares on Sabre. See Comments of Orbitz, at 43.

arrangement, it also receives something of considerable value, the offset to the CRS booking fee. Each airline can choose for itself which option best fits its needs. And if it chooses to participate in the arrangement, the airline retains full discretion over which of its fares to put in any other channel. Orbitz by contract forswears any ability to limit the airlines' discretion to do just that.

Furthermore, Orbitz is a new entrant with 0% share of tickets sold. It aspires to be the source of 2% of tickets sold in the next few years, if successful. Sabre, in contrast, is the source of almost 50% of all tickets sold. Nor even once launched will Orbitz have access to the portals that offer advertisers and websites the most effective and direct contact with 90% of Internet users. Travelocity and Expedia have locked up exclusive multi-year deals with AOL, Yahoo, MSN, and most other major portals. In short, not only is Orbitz's MFN clause very different from the Sabre's former clause, but the market position of Orbitz is very different from Sabre's.

Moreover, the marketplace results of Orbitz's MFN clause are entirely unlike those of Sabre. The Orbitz MFN provides for the wider dissemination of low fares to consumers than exists today, while Sabre's MFN provided no consumer benefits, as the Department recognized. Consumers also will benefit because Orbitz will lower airlines' costs by reducing their net CRS booking fees. The Orbitz associate agreement and MFN clause together offer airline competitors lower distribution costs, not a Sabre-like requirement that they incur higher costs. Orbitz will be the first distribution channel through which airlines economically can sell Internet fares, other than their own websites. As Orbitz explained in its comments, at pp. 46-47, airlines are under strong economic compunction to sell their tickets by every cost-effective means. See also Appendix A; Sabre Introduces Internet and Other Lowest Available Fares, Sabre News Release, March 13, 2000 ("[d]isplaying ... fares at the maximum number of distribution points increases the probability of reaching the customer"). Further, in return for access to Internet fares, Orbitz

is contractually committed to provide every participating airline unbiased displays, CRS booking fee offsets, and data ownership. Any CRS or website could have offered these benefits to airlines – but other than Orbitz, none has been willing to offer these overdue reforms.

In addition, the courts have recognized that a MFN clause or a similar agreement can help the smaller players in a market to compete against larger rivals. The Ninth Circuit recently held that a trade association policy which required dentists to disclose their lowest rates would enable a price conscious consumer to determine which dentists charged the lowest fees more easily and efficiently than ever before; the court concluded that the policy was not anti-competitive because “[l]ower search costs for consumers are generally understood to be procompetitive.” California Dental Association v. FTC, 2000 U.S. App. LEXIS 22421, \*32 (9<sup>th</sup> Cir. Sept. 5, 2000). In contrast, in those cases involving an MFN clause in which a non-litigated consent decree has been entered, the MFN clause was designed to ensure the continued market power of an already dominant player. See, e.g., United States v. Delta Dental of R.I., 943 F. Supp. 172 (D.R.I. 1997).

In sum, the Department observed in the parity clause proceeding that MFN clauses which “result in lower costs for airline participants or their customers, the traveling public” could be pro-competitive. See 62 Fed. Reg. at 59795. The Department should not ban the use of a pro-competitive MFN clause, whether it is the Orbitz MFN clause or that of another competitor.<sup>18</sup>

## **VI. The Department should repeal the mandatory participation rule.**

American Airlines, Delta Air Lines, and Lufthansa German Airlines have called on the Department to repeal the mandatory participation rule. The regulation was intended to protect competition among CRSs, but has also had the unanticipated consequence of eliminating even

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<sup>18</sup> See also Appendix A for Daniel M. Kasper’s discussion of the Orbitz MFN clause.



any minimal leverage that airlines subject to the rule might have had to negotiate the terms and conditions of their participation in CRSs. See, e.g., Comments of Lufthansa German Airlines, at

4. In contrast, the only party in this proceeding that has expressed satisfaction with the mandatory participation rule as it exists today is Sabre, the largest CRS in the world. See Comments of Sabre, at 19. The Department should be disconcerted that the largest monopolist that the CRS Rules were intended to regulate is content with the rules as they exist, even while many of the parties that the CRS Rules were intended to protect have asked the Department to reassess or repeal this rule.

The fact is that competition in airline ticket distribution needs and merits protection from the CRS monopoly far more than the CRS monopoly needs and merits protection from its airline customers. The mandatory participation rule operates as a government-granted franchise for CRSs. The rule effectively compels most airline customers of these behemoths to buy their services, whether or not they are suitable, reasonably priced, or wanted. The rule functions much as a government-granted monopoly would function – only government-granted monopolies normally are accompanied by public utility rate regulations to ensure that unreasonable prices do not result. The mandatory participation rule ensures the CRSs that their largest customers have no alternative but to buy their services, but then does nothing to ensure the customers that the prices they are charged will be reasonable. The Department should either repeal the mandatory participation rule or impose rate regulation on the CRSs. To mandate by government fiat that particular customers must buy from particular sellers, and to not at the same time regulate the sales price, precludes any chance of a competitive marketplace and is simply wrong.

**VII. The in-kind promotions clause of Orbitz’s associate agreements does not require, and is unlikely to cause, airlines to offer exclusive fares through Orbitz, and will promote competition.**

The American Antitrust Institute, Expedia, and Travelocity assert that the in-kind promotions clause of Orbitz’s associate agreements – which states that participating airlines will offer Orbitz in-kind marketing support – in fact will encourage those airlines to offer exclusive fares through Orbitz. AAI in particular alleges (without any substantiating evidence) that the agreements were written “with a wink of the eye.” Even though the agreements explicitly state that they are non-exclusive –participating airlines can put any fare offered on Orbitz up for sale through any other website or channel – AAI claims (again, without any substantiating evidence) that airlines are likely to choose to fulfill their marketing obligations to Orbitz by offering exclusive fares through Orbitz. See Comments of the American Antitrust Institute, at 7.

These parties misapprehend Orbitz’s in-kind promotions clause. At the outset, the clause should be understood in the context of the overall offer Orbitz makes to all airlines, as embodied in the charter associate agreement. Orbitz offers any airline the option of obtaining a substantial reduction in its current distribution costs (through the indirect offset of part of the CRS booking fees it pays); a contractual guarantee of unbiased display without any extra payments to protect itself from bias being sold to other airlines; ownership of the data generated by Orbitz for any booking on that airline; the option in the future to provide data to Orbitz by direct connect; and other commercial benefits. In return, the airline offers Orbitz any published fare that it sells elsewhere to the general public (the MFN clause) and a pledge of in-kind marketing support.

Central to this arrangement is, first, that it is completely at the option of the individual airline. If the airline chooses not to be an associate, it still will receive unbiased displays and an equal ability for consumers to book through Orbitz. And second, this is an arrangement designed

to offer the airline something of very real and immediate positive cash impact – the reduced net CRS booking fees – in return for obligations which have virtually no negative cash impact on the airline. The in-kind marketing provision is a way they can contribute something of real value to Orbitz – the ability to advertise to a relevant group of potential customers who otherwise might never find Orbitz, due to such barriers as the exclusives the two major online agencies have with the most widely used portals – at virtually no cost to the airline. This is of particular importance to low-fare and new entrant airlines, but also is an attractive arrangement to airlines of all types. The in-kind marketing concept is designed to be an opportunity for any airline to get something of direct cash value, in return for something that requires virtually no cash outlay.<sup>19</sup>

The in-kind promotions clause itself simply states that each associate airline has an obligation to provide in-kind marketing support to Orbitz of a dollar value roughly proportional to each airline's size; that the airline can fulfill that obligation as it chooses from among a nearly infinite number of alternatives; and that a list is provided which specifies the dollar values associated with some of the options. This list of some of the various means by which a participating airline can promote Orbitz includes such items as placing the Orbitz name, logo and web address in advertisements the airlines already had planned to run, in-flight materials (such as magazines, napkins, etc.), direct mail, and affinity program supplements, in addition to offering special fares through Orbitz. The list is not intended to be comprehensive; Orbitz is open to other marketing proposals from airlines. It is entirely – and obviously – each airline's decision

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<sup>19</sup> This opportunity stands in stark contrast to what Travelocity offers low-fare and new entrant airlines: that is, a chance to bid against the deep pockets of major carriers to purchase bias and become a “featured airline.” See Comments of Travelocity, at 20. Cf. Comments of Expedia, at 16. Travelocity offers no savings on booking fee costs and the “opportunity” to engage in an expensive bidding war to keep from being disadvantaged in display. Orbitz, in contrast, offers them significant savings on booking fees and non-biased displays (i.e., fully equal shelf space), and does so in return for in-kind marketing support which is designed to cost them virtually nothing. The

as to how it will meet its in-kind marketing obligations.<sup>20</sup> No airline is required to make any fare available exclusively to Orbitz by this clause, or any other clause, of its associate agreement with Orbitz.

Moreover, as Orbitz President Jeffrey Katz has explained, Orbitz does not anticipate that any participating airline will choose to offer special fares as a means of fulfilling its marketing obligations. See Katz on Orbitz: No collusion by U.S. carriers, Travel Weekly, at 31 (Sept. 21, 2000). Other promotional options, such as advertisements for Orbitz in in-flight magazines, signs in airport lounges, and logos on airline cocktail napkins, are virtually cost-free to airlines. The decision to distribute a fare through one channel, in contrast, can cost airlines real revenues if it would otherwise have been a fare sold through many channels.<sup>21</sup>

But this in-kind marketing, though virtually cost-free to the airlines, is of enormous value to Orbitz. Orbitz is locked-out of major advertising channels such as the top ten Internet portals, most of which have entered into long-term exclusive deals with Travelocity or Expedia. In-kind marketing will help Orbitz to obtain significant public visibility with limited cash outlays.<sup>22</sup>

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best competitive weapon that low-fare and new entrant airlines have is their low fares, not their cash reserves; only Orbitz will make it easier than ever before for online consumers to find and take advantage of airlines' best fares.

<sup>20</sup> Travelocity alleges that Orbitz has the right to dictate how smaller airlines must fulfill their promotional obligations. See Comments of Travelocity, at 13; Statement of Terrell B. Jones, President and Chief Executive Officer, Travelocity.com, before the Committee on Commerce, Science and Transportation, U.S. Senate, July 20, 2000, at 9-10. This allegation is without any foundation in the Orbitz associate agreement or any other source, and is simply untrue.

<sup>21</sup> Because Orbitz doubts that it will receive many (if any) such fares on an exclusive basis, there is no reason to believe that there will be anti-competitive effects even if it does.

<sup>22</sup> In part because of in-kind marketing, the costs of competing with Sabre/Travelocity, and their entrenched market power, will not prevent Orbitz from being a viable business or from in due course being profitable, contrary to statements by Sabre/Travelocity. See Comments of Sabre at 23, Comments of Travelocity at 20.

**VIII. Orbitz will not encourage price collusion among airlines, because the two necessary elements of collusion – secrecy and two-way communication – are entirely absent.**

The American Antitrust Institute, Expedia, and Galileo International express concern that Orbitz could be a vehicle for the exchange of pricing information among rival airlines. AAI also asserts that “[n]ew entrants have a better chance of gaining a foothold and growing if their prices are not always known by competitors.” Comments of the American Antitrust Institute, at 5.<sup>23</sup>

But as explained in Orbitz’s comments, at pp. 40-42, Orbitz will be useless as a means of collaboration because it will offer neither two-way communication nor secrecy. Orbitz will not have a mechanism that allows direct and private communication among airlines or from Orbitz to airlines about the fares of their competitors. Further, by definition, the only fares that participating airlines are obligated to make available through Orbitz are fares that would already be public information – i.e., they already will be known to competitors. Because all of Orbitz’s fare data will be relayed through ATPCO, all of the fare data will be compliant with the 1994 ATPCO consent decree. The decree does not prohibit an airline from communicating a fare to any party if, at the same time, that fare is being made public and is being put up for sale. See United States v. Airline Tariff Publishing Co., 836 F. Supp. 9 (D.D.C. 1994).<sup>24</sup>

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<sup>23</sup> AAI pontificates about what it thinks small airlines want. The true indication of what those airlines want is not AAI’s idle speculation but instead what many actually have done – that is, enter into associate agreements with Orbitz. As Midwest Express has explained, only Orbitz offers them unbiased displays and other unmatched commercial benefits. See Comments of Midwest Express Airlines, at 19-20. It is clearly the judgment of a number of small carriers that, contrary to the views of AAI, Orbitz is in fact quite advantageous to their interests.

<sup>24</sup> AAI further argues that the greater public availability of certain fares as a result of the Orbitz MFN clause will discourage “secret” deals between individual distributors and airlines. See Comments of the American Antitrust Institute, at 5. See Orbitz’s response in its discussion of MFN issues, at pp. 23-26.

**IX. Sabre and other CRSs continue to charge excessive booking fees, a burden which disproportionately impacts low-fare airlines and is passed on to consumers.**

Sabre asserts that the claim that CRS booking fees are excessive is propaganda and a myth. See Comments of Sabre, at 20. But the airlines that actually pay those fees disagree. In their most recent comments, they have informed the Department that booking fee increases since the last round of comments in 1997-98, as well as since the last CRS rulemaking in 1989-92, consistently have outpaced the Consumer Price Index. See, e.g., Comments of America West Airlines, at 12; Comments of American Airlines, at 5; Comments of Midwest Express Airlines, at 22-23.

Moreover, Sabre claims that the reason that booking fees today exceed those in effect for some airlines before the CRS Rules were adopted in 1984 is that the booking fees of the pre-Part 255 era did not actually cover the systems' operating expenses. Allegedly, increased booking fees compensated for the loss of incremental revenues traceable to display bias for airline-owners. See Comments of Sabre, at 20-21.<sup>25</sup> But even assuming the truth of this explanation,<sup>26</sup> the CAB predicted that once the CRS Rules entered into effect, the average full availability booking fee would range from 54 cents to \$1.00. See 49 Fed. Reg. at 11672. Sabre concedes that "[o]n the very first day of this new era," the CRS set its full availability booking fee at \$1.75 – more than 300% of the CAB's base estimate. See Comments of Sabre, at 21.

The excessiveness of CRS booking fees – and their 1400% increase since 1983 – is no myth. It is a painful reality, especially for low-fare airlines. The statement Orbitz made in its

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<sup>25</sup> The bold assumption underlying Sabre's argument is that it should be compensated fully for any revenue loss resulting from a government requirement that it stop anti-consumer, anti-competitive practices!

<sup>26</sup> As the Department no doubt recalls, CRSs once suggested that the existence of incremental revenues was itself a myth. Moreover, the Department concluded in its May 1988 Study of Airline Computer Reservation Systems that CRSs have continued to generate incremental revenues for their owners, despite the enactment of the CRS Rules.

initial comments was: “Since 1983, CRS booking fees have risen by approximately 1400%.”

Comments of Orbitz at 16. The 1400% figure is a matter of simple math. Until 1984, CRSs charged airlines (other than the airline that owned that CRS) booking fees that started at 25 cents per segment and were sometimes higher; in the case of airlines that were more of a competitive threat, or which had entered into a “cohost” agreement by which the CRS agreed to give it preferred display over other airlines (practices now prohibited by Part 255.6). The typical booking fee today is about \$3.75. That is an increase of \$3.50. And \$3.50 is 1400% of 25 cents.

If Sabre would like to present in this proceeding an alternative calculation by which their booking fees since 1984 have increased by only, say, 1000% – even while computing costs in our society have plunged by 99% – they are welcome to do so. But the conclusions that can be drawn from those calculations will be no different than the conclusions that can be drawn from the calculations in the comments of Orbitz.

As for whether booking fees are today excessive, Sabre long has held views that are as unique as they are self-serving. In 1983, when Sabre booking fees began at 25 cents, the Justice Department concluded that Sabre had “market power in many markets, and this enables them to obtain revenues well above costs.” Comments and Proposed Rules of the Department of Justice, Docket CAB-41686, at 144 (Nov. 17, 1983). In 1985, after the adoption of the CRS Rules, as well as a dramatic increase in the booking fees it charged, Sabre claimed to the Senate Commerce Committee that its booking fees were not excessive. The Government Accounting Office responded with a study that concluded in its comments to the Committee that Sabre in fact had significantly understated its profitability by undercounting revenues. See Airline Competition: Impact of Computerized Reservation Systems, GAO/RCED 86-74 (May 1986).

The most definitive study on the question, however, is the Department's 1988 Study of Airline Computer Reservation Systems, DOT-P-37-88-2 (May 1988), in which the Department thoroughly studied and reached its own conclusions on the issue. The Department found that, at a time when the average CRS booking fee charged by Sabre was \$1.84, Sabre's average cost of providing the booking (under what the Department concluded was the "most likely allocation of joint costs") was only 79 cents, and that the booking fee charged by Sabre equaled 233% "of their average cost of producing a reservation." See id. at 104-112. Sabre's profit margin was well over 100%! Sabre may not consider that to be excessive, but few others will be persuaded. And since that time, booking fees have gone up significantly, even while computing costs in our society have gone down dramatically.

In addition, Sabre argues that CRS booking fees today are reasonable, stating (without citation to authority) that they now amount to 1.5% of the price of the average fare. By way of comparison Sabre states (again, without citation) that Ticketmaster's service fee amounts to 15% of the average ticket it sells, and Ebay's service fee amounts to almost 7% of the average auction selling price. Id. at 21. But Sabre compares apples and oranges. The services offered by Sabre are unlike those of Ticketmaster, which sells concert, sports, and event tickets directly to the public. The allegation that Ticketmaster and other entirely dissimilar businesses charge higher fees than Sabre, even if true, does not prove that Sabre's fees are reasonable. Indeed, Sabre appears to be unaware that Ticketmaster long has been the target of accusations that its service fees are set at anti-competitive levels. See, e.g., Campos v. Ticketmaster, Inc., 140 F.3d 1166 (8<sup>th</sup> Cir. 1998); Bruce Mohl, Rising ticket fees pad concert profits, Boston Globe, Sept. 20, 1992, at 1.



Finally, as explained in Orbitz's comments, at pp. 16-17, CRS booking fees comprise a much larger percentage of the ticket price of low-fare airlines than of the average ticket price. That in turn disproportionately burdens low-fare airlines and the most price-sensitive consumers.

**X. Blown to Bits was not a "blueprint" for Orbitz, and in any case the book concludes that Internet competitors must offer consumers complete and unbiased information.**

The American Antitrust Institute, the Interactive Travel Services Association, Sabre, and Travelocity assert that a book published earlier this year, Blown to Bits by Philip Evans and Thomas S. Wurster, is in fact a "blueprint" for Orbitz's alleged plans to eliminate competition in airline ticket distribution. Allegedly, based on Blown to Bits, Orbitz plans to deny rivals access to the fare information and inventory they need to achieve "critical mass," and once its online competitors weaken or fail, Orbitz will inject subtle bias into its flight and fare displays. See, e.g., Comments of Travelocity, at 16-17.

These parties at best misapprehend (and at worst misrepresent) Blown to Bits. First, it was written by two consultants who had no role in the formation or operation of Orbitz. Second, Evans and Wurster provide a business school overview of the impact of the Internet on existing businesses at all levels of distribution, and possible responses by each; the book is not an action plan or "blueprint" for businesses in general, or for airline ticket distribution in particular.<sup>27</sup>

With respect to the first point, and completely setting aside the content of the book, the argument that Blown to Bits is a "blueprint" for Orbitz is completely unsupported by evidence, and is simply untrue. Evans and Wurster have written, for the Harvard Business School Press,

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<sup>27</sup> The Department also should not be confused as to the meaning of the phrase "blown to bits." It refers not to the elimination of traditional businesses, but to the elimination of the trade-off between the quality of information a business can offer and the number of people to which it can be conveyed. The phrase is a reference to the fact that the Internet has the capability to provide more consumers with higher quality information than was ever before possible, and thereby reduce the historic trade-off between the comprehensiveness and the reach of information.

what is essentially a new economy business school text. The two are also consultants with the Boston Consulting Group, one of them working in BCG's Boston office, the other in the Los Angeles office. Orbitz did, in its early days, retain BCG's Chicago office as a business start-up resource (a common type of arrangement among start-up businesses), but to suggest that Orbitz thereby endorsed and was guided by the private views of all 2,000 BCG consultants, scattered in over 40 offices around the world, is facially absurd. Further, the idea and plans for what is now Orbitz preceded Blown to Bits by nearly two years. Orbitz was, and is, a response by the airline industry to spiraling booking fee costs and display preference costs, and not a response to a book that was not even published until after Orbitz was created.

With respect to the second point – the content of Blown to Bits – Sabre/Travelocity have, by highly selective quotation, distorted its meaning. Specifically, Evans and Wurster start from the premise that “navigators” – businesses that provide information to consumers – play a crucial role in the marketing of goods and services. Moreover, they argue, a new breed of “insurgent navigators” has emerged along with the Internet; these new websites can provide more detailed information to a larger base of consumers than was ever before possible. The insurgents are said to present a challenge to existing suppliers and resellers of goods and services, because if they attain “critical mass” – and through it the ability to set standards that all others must follow – the insurgents would be able to dominate the provision of information to consumers. As a result, the actual producers of goods and services would lose the ability to control how their products and prices are presented to the consumer.

According to the authors, one of the strategies that existing businesses might adopt to respond to this challenge would be to “deny critical mass,” by blocking insurgent navigators’ access to key information. Another would be to offer the same navigation services as the

insurgents, but slanted in favor of existing businesses. However, the former strategy will not work, Blown to Bits recounts, if the insurgent navigators already have achieved critical mass; and the latter strategy is problematic because consumers doubt that navigation services offered by incumbent businesses will be unbiased. In practice, Evans and Wurster conclude, the only realistic option for existing businesses is to compete head-to-head with insurgent navigators, attracting consumers with better, truly impartial information.

Evans and Wurster have described a general model that in some respects tracks the evolution of the online travel industry. Two insurgent-like entities – Sabre’s Travelocity and Microsoft’s Expedia – have attained critical mass. Thus, the strategy hypothesized by Orbitz’s adversaries (i.e., preventing competitors from achieving “critical mass”) by definition could not work now, if it ever could. Moreover, the airlines cannot withhold their publicly available fare information – more than 99% of which is distributed through ATPCO – from these navigators, because they cannot afford not to reach the customers of these sites. And by buying their competitors and signing long-term deals with Internet portals, Travelocity and Expedia have established a clear duopoly over the flow of travel information to consumers online. Even if airlines were to ignore the economic incentives for them to sell their flights through as many channels as possible,<sup>28</sup> it is now too late in the day to prevent new entry in online airline ticket distribution, because Travelocity, Expedia, and other sites have achieved critical mass and are here to stay.

Thus, Blown to Bits indicates that the business strategy Orbitz should and must follow is to compete head-to-head with Travelocity and Expedia by providing unbiased and complete

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<sup>28</sup> These incentives are explained in Appendix A, the statement of Daniel M. Kasper.

information about airline fares and flights. In other words, Orbitz will attract consumers and airline clients, and survive as a business, only if it provides a better service, and not by some hopeless effort to withhold information from its competitors in order to weaken their business.

However, in other respects the Blown to Bits model does not describe online airline ticket distribution particularly well. The general model is designed to describe a retail business such as bookselling, which long has been a bricks-and-mortar operation, but now faces a raft of insurgent navigators selling books on the Internet. In other words, the model best fits a business for which computerized selling and the Internet arrived at the same time. For such a business, it is very clear who are the old economy suppliers and who are the new economy insurgent navigators.

Airline ticket distribution is unusual in that computerized selling arrived a quarter of a century ago, in the form of CRSs, while the Internet arrived in the past five years.<sup>29</sup> The CRSs have all the features of computerized information distribution, but without the consumer-driven choice that characterizes the Internet. Many CRSs have or are developing an Internet arm – should these arms be understood as insurgent navigators, or as handmaidens of the old order?

In this light, it might be more accurate to think of Orbitz, and not Travelocity or Expedia, as the insurgent navigator. Travelocity and Expedia rely on (and in the case of Travelocity, is largely owned by) purveyors of old technology. These websites in many ways are analogous to an old economy supplier, and are now confronted with the possibility of new Internet-based competition providing consumers more choice and a quantum leap in information quality. In this sense, Evans and Wurster might advise Travelocity and Expedia that they ultimately will have no

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<sup>29</sup> Indeed, Evans and Wurster describe Sabre as a textbook example of the pre-emption of new competition through a comprehensive-but-biased navigator. Only now has new technology sufficiently lowered entry barriers in airline ticket distribution such that Sabre's dominant position is being challenged, by Orbitz and other new entrants. See also Comments of USTAR, at 2 (USTAR is part owner of the emerging GENESIS alternative to existing CRSs).

choice but to respond to this new competition by upgrading their information technology and offering, as Orbitz will, a comprehensive and unbiased view of all the flight and fare options available to consumers.

Ultimately, because the automated distribution of airline tickets has evolved in ways so different from bookselling and most other industries, it can be difficult and confusing to try to draw analogies from Blown to Bits and apply them to airline ticket distribution.<sup>30</sup> For that reason as well as others it is pointless to think of Blown to Bits as a blueprint for Orbitz or any other entity in airline ticket distribution.

Finally, to the extent that the Department believes that Blown to Bits has any relevance to this proceeding, Orbitz urges the Department to read the unexpurgated text, and to not rely on the out-of-context excerpts offered up by those parties which have the greatest interest in erecting barriers to competitive entry.

**XI. The Department should not revise the United States CRS Rules for the sole purpose of achieving “harmony” with the CRS rules of the European Union and Canada.**

Amadeus, the Association of European Airlines, American Express, British Airways, Sabre, Travelocity, and the United States Travel Agent Registry have urged the Department to “harmonize” the United States CRS Rules with their characterization of the CRS rules of the European Union and Canada. See, e.g., Comments of the Association of European Airlines, at 4. The claim that the EU and Canadian rules already govern websites such as Orbitz – see, e.g., Comments of Amadeus, at 23 – is speculative at best. For example, Orbitz clearly is not covered as a CRS under the terms of the EU CRS rules, and Orbitz believes that EU regulators would

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<sup>30</sup> This confusion does create opportunities to distort by selective quotation, however. For example, Sabre alleges that certain passages of Blown to Bits urge existing businesses to boycott independent navigators. See Comments of

concur in that reading. The EU rules do impose certain limited obligations on a “subscriber,” which is defined as “a person, other than a consumer, or an undertaking, other than a participating carrier, using a CRS under contract or other financial arrangement.” EU Code of Conduct for CRSs, Articles 2(*l*) and 9a. But it seems doubtful that this subscriber language was intended to cover websites such as Orbitz, and the effect even if it did would be minimal. In Europe, as elsewhere, there is real doubt that the existing CRS Rules, drafted with traditional travel agents in mind, should or even could be applied to online agents such as Orbitz.<sup>31</sup>

The Department ideally should coordinate with the aviation authorities of other countries in regulating the distribution of airline tickets. But to the extent that rules adopted by other jurisdictions stifle competition and innovation, the United States should not, for consistency’s sake, behave like a lemming and follow them over a regulatory precipice. Moreover, while the goal of internationally “harmonized” rules has an attractive ring, the fact is that rules on airline ticket distribution are not the same in every foreign jurisdiction, and the Department would still face the issue of with which foreign CRS rules to “harmonize” the United States CRS Rules.

### **Conclusion**

Orbitz represents the first significant opportunity in two decades to inject new innovation and competition into the distribution of airline tickets. The Department should not adopt any regulatory proposals that would stifle the development of the Internet and further entrench the already dominant players, as exemplified by Sabre/Travelocity. And the Department especially

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Sabre, at 12. But these passages in fact comprise part of a general explanation of why the incentives of incumbent businesses will almost inevitably cause any effort to form a cartel to fend off new economy competitors to fail.

<sup>31</sup> But the Department should take note that some overdue reforms of the United States CRS Rules are already part of the EU and Canadian rules, such as a prohibition on unreasonable liquidated damages clauses in CRS-travel agent contracts. See EU Code of Conduct for CRSs, Article 9(4)(a). Cf. Canadian CRS Regulations, Article 36.

should not in haste attempt to regulate based on hypothetical and speculative concerns about future events which are unlikely ever to occur. However, to the extent to which new technology and the Internet will not be enough to create new competition to CRSs (particularly with regard to travel agent contracts), the CRS Rules should not only be continued but be substantially strengthened with respect to CRSs, and focused on preventing clear and present competitive abuses. The Department must walk a careful line in this proceeding; it should ensure that any new or revised rules are empirically justified, and actually will benefit consumers and competition.

Respectfully submitted,

A handwritten signature in black ink, reading "Frank J. Costello". The signature is written in a cursive style with a large, stylized "F" and "C". It is positioned above a horizontal line.

Frank J. Costello, Esq.  
Jol A. Silversmith, Esq.  
Paul E. Schoellhamer,  
Director of Government Affairs  
ZUCKERT, SCOUTT &  
RASENBERGER, L.L.P.  
888 Seventeenth Street, N.W.  
Washington, D.C. 20006-3309  
(202) 298-8660  
(202) 342-0683 (fax)  
fjcostello@zsrlaw.com  
jasilversmith@zsrlaw.com  
peschoellhamer@zsrlaw.com



**Exhibit A:**

**Statement of Daniel M. Kasper**

**Reply Comments of Daniel M. Kasper****LECG, LLC****Cambridge, MA****Introduction**

In their initial comments, several parties have raised questions with regard to the likely competitive implications of Orbitz's ownership structure and/or various provisions in Orbitz's agreements with individual airlines.<sup>1</sup> Although they do not contest the fact that Orbitz would likely spur price and service competition in the distribution of airline services, some parties nonetheless object to Orbitz because they believe it is an attempt by airlines to jointly dominate distribution of air transportation. According to these parties, Orbitz would enable such domination by denying access to a significant number of fares (and, hence, seats) sold by those airlines to competing distribution channels. Therefore, a number of these parties contend, the Department should preclude airlines with an ownership interest in Orbitz (or any other on-line distributor) from providing any fares exclusively to Orbitz (or any other airline owned on-line distributor) and should instead require airline-owners to provide other distribution channels with access to all of the fares made available to any airline owned channels. Finally, some parties also object to specific provisions, including the MFN (Most Favored Nation) provision, contained in Orbitz's airline agreements. The MFN clause requires participating airlines to make available to Orbitz all non-opaque published fares made available to the general public

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<sup>1</sup> It is noteworthy that most of the comments regarding Orbitz were made by parties that dominate existing airline distribution channels and for whom Orbitz represents the threat of new competition. Thus, it is not entirely surprising that many of the recommendations made by these commenters would, if adopted by the

through any other on-line channel,<sup>2</sup> including individual airline websites. According to these parties, the MFN provision is objectionable because, they believe, it would prevent airline participants from providing other distributors with exclusive rights to sell certain published fares and would therefore make it more difficult for airlines to engage in surreptitious price competition.<sup>3</sup>

Comments filed in support of Orbitz emphasize the important new competition benefits that Orbitz would bring to the distribution of airline services, particularly with regard to the dominant suppliers of CRS and on-line travel agency services. These comments also seek to dispel concerns raised by Orbitz's critics about the likely effects of Orbitz's agreements on the airlines' incentives and ability to engage in price competition through the use of specific distribution channels.<sup>4</sup>

A review of the initial comments pertaining to Orbitz makes it clear that the overriding differences in opinions stem from how one weighs the indisputably positive impact of Orbitz on competition in the distribution of air transportation – particularly with the highly concentrated CRSs and the two dominant on-line travel agencies – against the potential for competitive harm that some believe might arise from Orbitz's ownership structure and/or certain provisions in its agreements with participating airlines. In an effort to assist the Department in resolving this issue, I have analyzed the major potential

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Department, seriously weaken – or even eliminate – that threat to their existing positions posed by such competition.

<sup>2</sup> As explained below, in order to obtain access to fares because they have been made available by a participating airline to another distributor (e.g., Travelocity), Orbitz must also match the other terms and conditions negotiated by that distributor and the participating airline.

<sup>3</sup> See, for example, Comments of the American Antitrust Institute, pp. 13-14.

<sup>4</sup> See, for example, Comments of Orbitz, LLC and Statement of Daniel M. Kasper.

competitive “harms” identified by other parties to determine whether or not these projected effects are consistent with economic principles. Specifically, I have examined the likely effects of Orbitz on the economic incentives of airlines to engage in vigorous price competition.

Based on this analysis, I have concluded that:

- a) the overall impact of Orbitz is likely to be strongly pro-competitive;
- b) claims that Orbitz will dominate or monopolize the distribution of airline services are simply not credible in light of the economics and structure of the existing distribution market, as well as market share projections made by independent analysts and by Orbitz;
- c) in the unlikely event such harms materialize in the future, the Department will have ample time to fashion appropriate remedies based on facts rather than speculation by Orbitz’s competitors; and
- d) the MFN and other provisions questioned by some parties will reduce neither the incentives nor the ability of individual airlines to engage in blatant or surreptitious price competition. Instead, the MFN provision is more likely to spur new and innovative competition by the existing on-line agencies and CRSs that currently dominate airline distribution.

### **Airline Interests and Incentives**

Any discussion of airline incentives to use (or favor) Orbitz must start with a recognition that airlines have well-founded concerns about – and a legitimate interest in controlling –

the rising cost of distributing their products. Even using Sabre's own data, the booking fees charged by CRSs have increased since 1984 at a rate approximately 15 percent faster than the Consumer Price Index,<sup>5</sup> notwithstanding the fact that the costs of both computing power and data transmission – two major components of CRS costs – have fallen sharply over the same time period.<sup>6</sup>

A second important consideration in evaluating Orbitz is the fact that the travel agency channel is far and away the predominant distribution channel for airline services in the United States today, accounting for approximately 80 percent of all airline tickets sold. A third consideration is the dominant position in airline distribution that is held collectively by only four CRSs. In total, these four firms handle over 80 percent of all US airline bookings, with Sabre alone accounting for roughly 50 percent of all such CRS bookings.<sup>7</sup> A fourth important factor is that two firms – Travelocity (owned by Sabre) and Expedia (owned by Microsoft) – control over 63 percent of on-line agency sales,<sup>8</sup> due at least in part to the fact that they have secured exclusive access to the dominant Internet portals, i.e., the electronic gateways most consumers use to access the Internet.

An evaluation of the ownership structure of Orbitz must consider the important structural and competitive conditions that characterize the distribution of air transportation today. It should thus consider the fact that investing in a new B to C e-commerce venture,

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<sup>5</sup> Comments of Sabre, Inc., p. 21. The difference between the rate of increase in CRS booking fees compared to the CPI amount to 15% per year.

<sup>6</sup> The cost per million instructions per second (MIPS), a standard measure of computer processing efficiency, has fallen from \$480 in 1978 to \$4 in 1995. Likewise, the cost to transmit data declined by three orders of magnitude between the mid-1970s and the beginning of the 1990s. "Transmission Costs are Plummeting." ([www.neweconomy.com](http://www.neweconomy.com))

<sup>7</sup> Comments of Orbitz, LLC and Statement of Daniel M. Kasper, pp. 15.

particularly one seeking to compete against entrenched incumbents in the highly concentrated CRS and electronic ticket distribution sectors, is likely to be viewed by investors as a high risk undertaking, at best. Under recent financial market conditions, investors are likely to be even more skeptical regarding the prospects for such a venture, particularly where – as here – the dominant incumbent on-line travel agents have entered into contracts giving them exclusive rights to the most heavily used Internet portals.

Moreover, since the success of Orbitz's strategy depends on its ability to obtain access to all published fares – something that requires, at a minimum, the cooperation of most major airlines – and since these same airlines would be among the principal beneficiaries of a reduction in distribution costs, it is surely not surprising that potential outside investors would demand strong evidence of major airline support for Orbitz before putting their own capital at risk. The use of a joint venture such as Orbitz is well established as an efficient and legitimate way to share such risks. Likewise, the willingness of airlines to invest in Orbitz lends important credence to the existence of significant expected cost savings and signals to the financial markets the support for Orbitz that is critical to attracting other investors.

Is An Airline Likely to Deny Other Channels Fares It Provides to Orbitz?

In an effort to evaluate some parties' concern that an airline might deny other distribution channels access to more of its fares, I have analyzed the incentives that an airline owner of Orbitz would face if requested by another distributor to make all the

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<sup>8</sup>Comments of Orbitz, LLC and Statement of Daniel M. Kasper, pp. 17.

fares offered through Orbitz available to that distributor in return for a “bundle” of terms equivalent in value with those provided by Orbitz. In addition, I have analyzed the possibility that, absent governmental intervention, airlines would broaden significantly the categories of fares available only from individual carrier websites or from Orbitz.

My analysis of airline incentives suggests that: (a) airlines have – and will retain – strong, independent incentives to use a wide array of distribution channels for most fares/seats; (b) airlines have – and will retain – strong incentives to provide distributors with access to as many fares as these distributors can economically sell; and (c) while airlines might prefer to increase the proportion of sales transacted through their own individual websites (because these represent the least costly distribution channel), it is unlikely that it would be profitable for an airline to broaden significantly the number of fares available exclusively on its own website. Furthermore, the incentives facing airlines appear to be consistent with the interests of both consumers and competition because they encourage both airlines and other distributors to lower the cost and improve efficiency in the distribution of air transportation, which will, in turn, put downward pressure on the prices charged for airline services.

#### Airlines Must Use a Broad Array of Distribution Channels to Attract Passengers

Like producers in many other industries, airlines have strong incentives to use multiple distribution channels to sell their products. In the case of airlines, these channels include travel agents (both traditional and on-line), airline city ticket offices, airport ticket counters, direct bookings both online and over the phone, plus consolidators and third

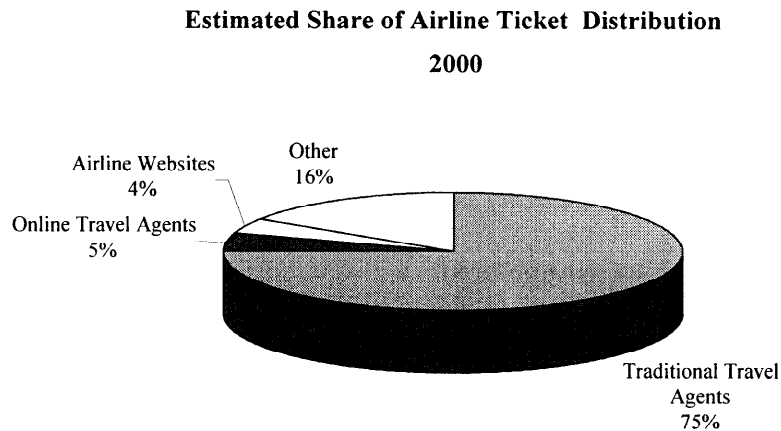
party websites such as Hotwire.com and Priceline.com. When technology permits new distribution channels to emerge, it is common for firms in competitive industries (including airlines) to move quickly to utilize these additional channels. The emergence of the Internet as a viable means of selling goods and services, for example, has resulted in its widespread adoption -- by producers in virtually every sector of economy -- as an *additional* distribution option rather than as a replacement for existing distribution channels.

Airlines utilize many different distribution channels for the simple reason that *they must do so* in order to ensure that their products are easily accessible to the broadest possible array of prospective travelers. Indeed, no single distribution channel can cost effectively serve all potential consumers. Because attracting incremental passengers is critically important to an airline's profitability, each airline strives to match or surpass the visibility to purchasers enjoyed by its rivals. That is, airlines must compete for "shelf space" in any channel where consumers prefer to shop. As a result, competition would prevent an airline from bypassing any significant distribution channel, even if it wanted to do so. As discussed further below, it is highly unlikely that the establishment of Orbitz will change the incentives that compel airlines to use multiple channels for nearly all of their fares and seat inventories.

Despite the fact that most firms would *prefer* to sell as much of their product as possible through the least costly channel, they almost never do -- for the simple reason that the least costly channel for producers is rarely the channel preferred by most consumers.



Thus, even though airlines would prefer to sell their tickets directly to consumers via their own websites in order to reduce (or in fact eliminate) costs such as CRS booking fees and travel agent commissions, the overwhelming majority of tickets are sold through travel agencies, one of the most expensive distribution channels. Airlines continue to rely heavily on the agency channel because most consumers have demonstrated a strong preference for buying tickets from travel agents.



Source: "Airlines: Reshaping the Industry's Business Model", Merrill Lynch, April 8, 1999  
PhoCus Wright Yearbook, 1999

### Availability of E-fares

Traditionally, airlines have made most publicly available fares accessible to every distribution channel. Just as airlines have strong incentives to use every available distribution channel, they face strong incentives to ensure that each channel has access to as much of their inventory as possible. This is because consumer demand for different types of an airline's products is not, in general, segregated by distribution channel. As a result, an airline cannot typically afford to hold back any significant portion of its

(publicly available) inventory from particular distribution channels. Moreover, the highly perishable nature of an airline's inventory provides an even greater incentive for each airline to ensure that it has as much "shelf space" as possible in order to minimize the number of empty seats on its flights.

The sale of low-priced distressed inventory known as "e-fares," however, would likely be uneconomic if burdened with the full cost of agency commissions and CRS booking fees. As a result, these very low margin products are typically offered only on an airline's own website, by far the lowest cost distribution channel currently available to an airline. In the case of Orbitz, however, these added costs would be more than offset by the savings an airline would realize from the approximately 30 percent CRS rebate it would get *for all of its fares sold through Orbitz*. If sales by Orbitz amounted to 2 percent of the sales of participating airlines that are now subject to booking fees, the savings to airlines would amount to \$12.6 million per year.<sup>9</sup> It is these additional savings that make it economically worthwhile for airlines to provide Orbitz with access to their e-fare inventories.

Moreover, if other distribution outlets offer savings comparable to those offered by Orbitz<sup>10</sup> (i.e., reduced booking fees *on all fares sold via that outlet*), airlines would have strong incentives to make e-fares available through these additional channels. This is the case because the booking fee savings each participating airline would get on the far larger number of other fares sold would more than offset the added costs of permitting these

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<sup>9</sup> LECG analysis of 1999 CRS marketshare and financial data.

distribution outlets to sell the small number of e-fares. If Orbitz's rebates were matched by distributors accounting for 20 percent of sales, for example, the airline savings would increase to \$126 million annually.

The economic advantages are equally compelling from the perspective of individual carriers. Suppose, for example, that Travelocity offered Northwest Airlines a 30% booking fee rebate on *all* ticket sales made through Travelocity in exchange for the ability to sell Northwest's e-fares. Despite the fact that Northwest would have to absorb additional travel agent commissions and CRS booking fees on the e-fares that Travelocity booked, these costs (roughly \$17 per ticket<sup>11</sup>) would be overshadowed by the rebates Northwest would obtain on non e-fare tickets: Northwest would gain over \$3,000 in booking fee rebates for every e-fare booked by Travelocity.<sup>12</sup>

The willingness of participating airlines to provide e-fares to Orbitz supports the conclusion that airlines have strong incentives to use any channel that promises to reduce distribution costs. And given the substantial cost savings that an airline could obtain if another distributor (e.g., Travelocity) were to offer an airline terms truly equivalent in value to those offered by Orbitz, there is little reason to believe that the airline would not accept such an offer.

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<sup>10</sup> Airlines are willing to give Orbitz access to e-fares because of the savings in booking fees Orbitz offers for all fares it sells on participating airlines.

<sup>11</sup> E-fare ticketing costs are computed as \$10 in capped travel agency commissions plus CRS booking fees for 2 segments, as the overwhelming majority of e-fares are non-stop flights.

<sup>12</sup> Since e-fares account for 0.1% of all tickets sold (Statement of Kenneth Mead, Inspector General, USDOT, "Internet Sales of Airline Tickets", July 20, 2000, pp. 9), Travelocity would sell 999 other tickets

Availability of Additional (Non-E) Fares

Just as an airline has little incentive to restrict the availability of e-fares from channels that could cost-effectively market them, it also has little incentive to broaden the category of fares offered only on its own website (or Orbitz's) since that would undermine the airline's ability to make its products available to the widest possible market. Major airline websites typically account for less than 10 percent of total ticket sales.<sup>13</sup> If an airline limited distribution of fares to Orbitz and its own website, it would lose approximately 90 percent of the distribution channel "shelf space" it currently uses to distribute such fares. As a result, the airline would lose substantial revenues to competing airlines that did not forego access to 90 percent of distribution channel "shelf space." The foregone revenues (and profits) from ticket sales that could have been made by other distribution channels would far outweigh the potential cost savings that could be realized from any incremental purchasers who were attracted to the airline's website in search of a fare exclusively available only on that website.

For purposes of illustration, suppose that Northwest Airlines chose to make its 14 day excursion and promotional fares – which account for roughly 15% of its domestic revenue – available only via its own website and Orbitz. In order for this strategy to be profitable for Northwest, the CRS rebates provided by Orbitz would have to be greater than any loss in profits from reduced sales to passengers lost as a result of the reduced

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with an average rebate of \$3.12 for each e-fare it books (as calculated from data provided by US DOT and Inspector General Kenneth Mead).

<sup>13</sup> In 1999, US Airways and Continental booked 6% and 3.8% of their tickets on their respective websites. Northwest has booked 4.1% of its tickets on-line through the first three quarters of 2000. As it is in so

distribution channel availability of those fares. Based on Northwest data, Orbitz would have to attract nearly 80% of passengers who would have purchased these excursion tickets in order for this strategy to be profitable to Northwest.<sup>14</sup> But it is totally unrealistic to expect Orbitz to capture such a high proportion of passengers. To begin with, only 10-15 percent of passengers book their travel on-line. And more than 90 percent of passengers using these fares have historically booked these fares on channels other than Northwest's website, most of them using travel agents. Under highly optimistic assumptions,<sup>15</sup> Orbitz might be able to attract 10% of passengers seeking 14-day excursion tickets to its website; the net result to Northwest would be a \$35 million annual loss.<sup>16</sup> These results are summarized in the table below:

Percentage of Excursion Passengers Migrating to Orbitz	Net Profit (Loss) Effect on Northwest per year
10%	-\$35,093,641
25%	-\$27,440,720
50%	-\$14,685,851
80%	\$619,993

many other ways, Southwest is a notable exception, booking a significantly higher percentage of its tickets on-line.

<sup>14</sup> Source: LECG analysis of Northwest data 1999 10K data and data cited in "Hub and Network Pricing in the Northwest Airlines Domestic System," by Robert Gordon and Darryl Jenkins. Analysis assumes that Northwest books 6% of tickets via their own website and earns the 1998 industry median return on revenues of 5.5% (Fortune 500).

<sup>15</sup> Despite the fact that Internet travel is growing, nearly half of all U.S. households are still not connected to the Internet. (Source: [www.netsizer.com](http://www.netsizer.com)). Furthermore, of those households that do have access to the Internet, the vast majority (85%) do not make purchases online. (Source: "Internet Travel", Bears Stearns, April 2000).

<sup>16</sup> Even these figures substantially understate the negative effects such a strategy would have on Northwest. If Northwest's competitors did not limit similarly limit the availability of their excursion fares, they would be virtually certain to capture traffic and revenues that would otherwise have gone to Northwest. Since virtually all passengers have a choice of multiple carriers on a given route, many passengers who could no longer use their preferred channel to book excursion fares on Northwest would simply choose to fly on other carriers. Moreover, travel agents denied access to Northwest's excursion fares would have less incentive to sell Northwest's other fare offerings. Based on the well-recognized network effects of hub-and-spoke systems, the loss of excursion passengers would have a ripple effect on Northwest's overall system leading to reductions in flights, destinations and system profitability.

In sum, an airline would likely lose far more by restricting access to the vast majority of its fares (and seat inventory) than it could possibly hope to gain from the cost savings on any incremental sales – via Orbitz’s or its own website – that such restrictions might generate.

### **Airline Incentives Are Consistent with Economic Efficiency and Consumer Interests**

An airline’s incentives to (a) use as broad an array of distribution channels as possible, (b) provide each distribution channel with access to as many fares as that channel can economically sell, and (c) increase the proportion of sales transacted through the most efficient channels are all consistent with economic efficiency and the interests of consumers. Because consumers value the ability to purchase goods and services at the lowest possible price and in ways that are most convenient for them, airlines are required as a practical matter to make the vast majority of their fares – and seat inventories – available through a wide array of distribution channels. In addition, an airline’s ability to increase the proportion of sales transacted through the least costly distribution channels is restricted by a strong and persistent consumer preference for other channels – particularly for travel agencies, which currently account for approximately 80 percent of all tickets sold. As a result, airlines will continue to face strong incentives to make the overwhelming majority of their fares and seats available to all distribution channels. To the extent that other distributors want access to a miniscule number of fares<sup>17</sup> that would be available only on Orbitz and individual airline websites, these distributors will find it

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<sup>17</sup> Statement of Kenneth Mead, Inspector General, USDOT, “Internet Sales of Airline Tickets”, July 20, 2000, pp. 9.

necessary to meet or beat the terms offered by Orbitz. This in turn will provide an important and badly needed stimulus to competition and efficiency in the distribution of air transportation, particularly for the dominant CRSs.

### **The MFN Provisions Are Unlikely to Reduce Competition**

Some parties have suggested that the provision in Orbitz's airline agreements that requires participating airlines to provide Orbitz with access to all their published fares on a Most Favored Nation (MFN) basis would reduce competition by precluding "special pricing deals" between an airline and other distributors that might be expected to spur additional price competition among airlines, particularly new entrants and low fare airlines.<sup>18</sup> Upon careful examination, however, these concerns appear to be unfounded, in part, at least, because they are based on fundamental misunderstanding of the MFN provision, airline incentives, and important facts about the nature and availability of different types of airline fares.

To begin with, Orbitz's agreement with airlines does not prevent any airline – new entrant, low-fare or large network incumbent – from entering into special pricing (or other promotional) deals. Under the terms of this agreement, for example, the MFN provisions apply only to published fares available to the general public; they do not apply to the wide array of special fares – including corporate fares, tour operator fares, off tariff fares, group fares, meeting and incentive fares, government fares, opaque consolidator

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<sup>18</sup> See, for example, Comments of the American Antitrust Institute, pp. 13-14.

fares, affinity fares, auction site and other opaque fares<sup>19</sup> – that have been used historically by new entrants and other airlines to cut prices surreptitiously in an effort to build passenger volumes without precipitating across-the-board price wars. In fact, several post-deregulation airlines have successfully entered the airline business by negotiating special deals with large corporate customers,<sup>20</sup> deals that would not be precluded by Orbitz's Charter Associate Agreement, nor would they trigger the MFN provision in that agreement.

Moreover, Orbitz's agreement with airlines specifically excludes net fares from the application of the MFN provision. Thus, airlines remain free to offer other distributors the exclusive ability to purchase and re-sell seats to consumers on a net fare basis, typically at steep discounts. In short, an airline participating in Orbitz continues to have the option – consistent with its agreement with Orbitz – to offer surreptitious price reductions, should it chose to do so.

In addition, nothing in the Orbitz agreement precludes any airline from agreeing to provide Travelocity or any other on-line agency with exclusive access to non-public fares. Nor does the Orbitz agreement preclude any airline from entering a "special deal" with Travelocity (or any other distributor) whereby that airline pays for preferential display of its fare offerings.

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<sup>19</sup> Amended and Restated Airline Charter Associate Agreement, Article 2.1 and Exhibit A.

<sup>20</sup> Midwest Express was established and initially owned by a large corporation that provided the carrier with a critical "base load" for its operations. More recently, ProAir used corporate "special deals" with major automakers to establish itself in Detroit.



Finally, and perhaps most importantly, the MFN provision ensures Orbitz access to the same “terms and conditions” offered to another on-line agency *if and only if* Orbitz is willing to match those terms. If Orbitz were unwilling or unable to match the terms of a special deal proposed by Travelocity to a participating airline, Orbitz would not have access to those fares based on the fact that they were made available to Travelocity, notwithstanding the MFN provision in Orbitz’s airline agreements. Thus, far from stifling competition, the existence of the MFN provision will provide a powerful incentive for other on-line agencies to compete with Orbitz by offering savings to airlines with terms and conditions that Orbitz would find difficult or impossible to match.

In short, the Orbitz agreement diminishes neither the incentives nor the ability of participating airlines to negotiate “special pricing deals” with distribution channels other than Orbitz. Nor does the agreement otherwise preclude airlines from engaging in other, non-public forms of price cutting. Rather, by providing Orbitz with a competitive foothold against the entrenched on-line agencies and CRSs, it is likely that the MFN (and other provisions) in Orbitz’s agreements will benefit consumers by injecting new competition in the distribution of air transportation, thereby lowering the cost of distributing airline products and, ultimately, the costs of air travel.

### **Proposed Regulations Would Hurt Competition, Consumers and Orbitz**

Imposing a requirement that a participating airline must make all fares offered to Orbitz available to other channels would perversely affect not only Orbitz, but also competition

and consumer welfare. If other distributors automatically have the right to the same fares as Orbitz, they would have little incentive to offer comparable or greater distribution cost savings to the participating airline. As a result, airlines would be unlikely to realize the full potential savings in distribution costs inherent in the Orbitz business model. Without comparable economic concessions, airlines are unlikely to make their low e-fares available to other distribution channels since the higher cost of using those channels would make these low e-fares uneconomic. As a result, airlines would be disinclined to offer these e-fares through Orbitz (or any other 3<sup>rd</sup> party distribution channel), thus denying consumers the benefits of Orbitz's unbiased display and the convenience of its one-stop comparative shopping when searching for low fares. Moreover, if Orbitz is denied access to the low e-fares that are currently available only on individual airline's websites, a key element of its strategy for attracting customers to its site would be eliminated, and this would reduce significantly the likelihood that Orbitz would emerge as an effective competitive spur to the incumbent firms that dominate the CRS and electronic ticket distribution sectors.

### **Summary and Conclusions**

Notwithstanding the prospect that Orbitz will provide new and effective competition to the existing CRS providers, some parties apparently are skeptical of Orbitz based on the fact that it would be owned, at least initially, by several major airlines. I believe these concerns are misplaced. Orbitz is expected to garner only a tiny share of sales, even under its most optimistic projections, and there is simply no credible evidence to suggest

that airlines and/or Orbitz will dominate electronic distribution, let alone the far larger distribution market.<sup>21</sup>

If the Department were to impose regulations on Orbitz – with the exception of non-discriminatory display bias rules – as proposed by a number of parties, it would effectively kill the threat of real competition that Orbitz poses to the entrenched suppliers of CRS and electronic distribution services. It would also foreclose for the foreseeable future the possibility of relying on market forces to discipline the cost and quality of CRS services. What will then be left is a highly-concentrated CRS business whose dominant players enjoy significant market power, insulated from the prospect of effective competition. Under these circumstances, the Department would have to consider seriously the establishment of a more robust and comprehensive regulatory regime than the current CRS rules, one that entailed more substantial regulation of CRS fees and competitive practices.

Since even under its most optimistic of assumptions, Orbitz will be only a small player in airline distribution for many years to come, it is both unnecessary and unwise to roll out the heavy regulatory artillery advocated by some parties. Rather, it would make far more sense for the Department to avoid imposing on Orbitz – and other emerging on-line distribution channels – regulations that risk killing the important competitive potential that these new options would bring to the business of distributing air transportation.

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<sup>21</sup> A study recently released by the International Data Corporation concluded that “Airlines will not dominate online airline ticket sales, despite the planned launch of an airline-owned Web travel venture.” See, “Airlines will not lead Web travel sales, study says”, Reuters, September 18, 2000.

Instead, the Department should let the forces of competition play themselves out under the Department's watchful eye. If, as is likely, the effects of competition from Orbitz and possibly other new e-distributors, prove to be beneficial and efficiency-enhancing, the Department need do nothing further. If as its opponents speculate, Orbitz is used for anti-competitive purposes, the Department retains the authority to institute a rule-making or enforcement proceeding at any time. In either case, the Department will have the benefit of actual experience with competition from Orbitz and others rather than basing its decision on speculation about what might or might not happen, and how or when it might happen, in the future.

**Exhibit B:**

**Joint Statement of Steven A. Morrison, Clifford Winston, and Robert E. Litan**

**THE COMPETITIVE POTENTIAL OF THE ORBITZ  
ONLINE TRAVEL AGENCY**

**Steven A. Morrison   Clifford Winston   Robert E. Litan**

**October 2000**

Five major airlines—American, Continental, Delta, Northwest, and United—have started an online travel agency called Orbitz. We have been asked by Hogan & Hartson, L.L.P. and Zuckert Scoutt & Rasenberger, L.L.P. to give our opinion on the economic consequences of this project including potential benefits to travelers and possible anti-competitive effects. We have also been asked to give our view whether it is appropriate for the federal government at this time to regulate Orbitz's conduct in any way.

In a nutshell, our position is that the creation of a new Internet-based travel agency, of the type represented by Orbitz, has the potential to enhance consumer welfare without undermining the competitive workings of the airline industry. We therefore strongly recommend that the government refrain from taking any steps to regulate Orbitz at this time. If anti-competitive problems should later emerge, they can and should be dealt with at that time through the normal antitrust process that governs all other commercial conduct in other industries.

### **Institutional Context**

Online travel reservations and ticketing have evolved with the growth of the Internet and the development of search engines. These systems also make use of computer reservations systems that have existed for decades. It is therefore important in understanding the potential consequences of the proposed joint venture for policy makers to be aware of the relevant background of these systems, including the rules that govern their use and their costs to airlines.

Computer reservations systems (CRS) developed in the late 1960s as an outgrowth of airlines' internal reservation systems. Since the early 1980s, policy makers and analysts have been concerned about the effect that such systems could have on airline competition. In 1984, the Civil Aeronautics Board issued regulations outlawing display bias, which arose from the fact airline owners of CRSs would display their own flights higher on CRS screens than would be the case with a neutral ranking. Travel agents, however, remained free to bias the unbiased information they received from CRSs. The logic of this distinction was that, whereas travel agents were locked into long-term contracts with (usually) one of the handful of CRS vendors, travelers were free to take their business to the travel agency that best served their needs.<sup>1</sup>

Beginning in the mid-1990s, World Wide Web-based travel agencies (such as Expedia.com and Travelocity.com) have emerged. These firms obtain their underlying fare and schedule data from one of the four current CRSs and use the systems as their booking engines. Because the online travel agencies are not CRSs, but simply use CRS information as conventional travel agents do, they are not subject to CRS anti-bias regulations (as is also the case with conventional travel agents).<sup>2</sup>

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<sup>1</sup> In fact, two of us previously have found that travelers suffered little loss in welfare even if airlines biased their CRSs. See Steven A. Morrison and Clifford Winston, *The Evolution of the Airline Industry* (Brookings, 1995). The intuition behind this finding is that competition leads to similar fares among competing carriers and most fliers want more than a cursory search of a CRS. Many, accustomed to buying tickets to take advantage of a specific frequent flier program, insist on getting flight information about their regular carrier even when others offer lower fares or more convenient schedules. Experienced travelers are the heaviest users of airline services—less than 10 percent of air travelers account for nearly 45 percent of all air trips. And they are undoubtedly aware of alternative carriers.

<sup>2</sup> *Consumer Reports Travel Letter*, September 2000, reports that “our testing of these sites [Travelocity.com, Expedia.com, Lowestfare.com, and Cheaptickets.com] did not yield



In March 2000 AMR, the holding company of American Airlines, completed its spin-off of Sabre, which now has no airline owners. Currently, only one of the four CRSs is majority owned by U.S. airlines.

In the airline business, once a plane takes off, the carrier loses any possible revenue from seats that were not sold. Understandably, therefore, airlines place a high value on incremental sales and distribute their product widely using their own reservations agents, their own web sites, traditional travel agents, online travel agents, ticket consolidators, and any other lawful means available for selling tickets. The effort that airlines expend on ticket distribution now represents their third largest expense after labor and fuel.

The level of CRS booking fees has been an issue for many years. The Department of Transportation issued a report in 1988 that concluded that under its most likely allocation of joint costs, four of the five CRSs operating at that time charged booking fees that were greater than the average unit cost per passenger segment booked (about twice as great in three of the four cases).<sup>3</sup> (The CRS with fees below its estimated costs was the smallest of the five and later merged with another CRS.)

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conclusive findings, but did reveal some evidence that travel sites may not be totally objective at all times.” “Clearly there is reason to question the display methods of online travel booking sites.”

<sup>3</sup> U.S. Department of Transportation, Office of the Secretary, *Study of Computer Reservation Systems*, DOT-P-37-88-2, May 1988.

When a traveler books a ticket through a conventional travel agent, the airline pays the agent a commission (currently averaging about 6-7 percent) and pays the CRS vendor a fee per segment booked of approximately \$2-\$4. (The Department of Transportation reports that the average booking fee for a round trip ranges from \$10-\$16.<sup>4</sup>) Tickets booked through an online agency are still subject to the CRS booking fees, but the travel agent commission is lower than the rate for conventional travel agencies (5 percent with a maximum of \$10).<sup>5</sup> No CRS booking fees or travel agent commissions are paid for bookings through an airline's own reservation agents or web site. See the following table.

**Estimated Cost of Booking through Alternative Distribution Channels**

<b>Airline</b>	<b>Airline Web Site</b>	<b>Airline Reservation Agent</b>	<b>On-Line Travel Agent</b>	<b>Conventional Travel Agent</b>
Southwest <sup>1</sup>	\$1	\$5		\$10
Unspecified Airline 1 <sup>2</sup>	\$6	\$13	\$20	\$23
Unspecified Airline 2 <sup>2</sup>	\$15	\$26	\$36	\$53
<sup>1</sup> Statement of Southwest Airlines before the Senate Commerce, Science, and Transportation Committee, Concerning Internet Sales of Airline Tickets, July 20, 2000. <sup>2</sup> Statement of Kenneth Mead before the Senate Commerce, Science, and Transportation Committee, Internet Sale of Airline Tickets, July 20, 2000, CR-2000-111.				

<sup>4</sup> Statement of Kenneth Mead before the Senate Commerce, Science, and Transportation Committee, Internet Sale of Airline Tickets, July 20, 2000, CR-2000-111.

<sup>5</sup> U.S. General Accounting Office, *Domestic Aviation: Effects of Changes in How Airline Tickets are Sold*, GAO/RCED-99-221, July 1999.

These data suggest that airlines could significantly lower their costs by using distribution channels that reduce or do not require booking fees or travel agent commissions. Reducing booking fees is the economic incentive that the founding carriers have for developing Orbitz and for delivering savings to consumers.

### **Orbitz**

Orbitz is a travel web site founded by five major airlines, American, Continental, Delta, Northwest, and United. Initially scheduled to debut in September 2000, the launch has been delayed to June 2001. Initially, Orbitz will rely on a CRS (Worldspan) to book tickets. That is, Orbitz will display information about all carriers and expects to sell tickets on all carriers that “participate” in Worldspan.<sup>6</sup> Airlines that contractually become “Charter Associates” of Orbitz agree, among other things, to provide all “Published Fares” to Orbitz. In return, they receive a rebate on the CRS booking fee.

Orbitz will use state-of-the-art technology to search through all fare and schedule information and present the traveler with an unbiased display of results, from lowest fare to highest.

- All airlines displayed on Orbitz will be treated equally with respect to screen display. (This is a contractual obligation between Orbitz and its Charter Associate members, to which no other online site subjects itself.)
- All Charter Associates will receive the same services and benefits as the airline investors (who are also Charter Associates).

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<sup>6</sup> An airline “participates” in a CRS if it makes its services saleable through the CRS. Not all airlines do this. Southwest Airlines, for example, only participates in the Sabre system.

- All airlines, including Charter Associates, are free to compete with Orbitz and invest and participate in competing ventures.
- All airlines, including Charter Associates, are free to decide what fares they will offer and are free to offer any fares, including internet-only fares, to any other distribution outlet they may wish, including off-line and online agencies.

In addition to providing unbiased displays, Orbitz will be an attractive distribution channel for airlines (that are Charter Associates) because it will share with airlines a portion (60%) of the booking fee rebate that it receives from the CRS vendor on which the reservations are actually made. Orbitz will receive a rebate because of the volume of its bookings. The rebate will not be less than \$1 per ticket or more than \$3 per ticket.

In the future, Orbitz plans to offer the option to bypass the CRS altogether and have its system communicate directly with each airline's internal reservation computer. In fact, Orbitz has a contractual obligation to its Charter Associates that, at a Charter Associate's request, and "subject to technical and financial constraints, [it will] use its reasonable business efforts to connect directly to the Airline Internal Reservation System...so as to eliminate the need for a CRS link..."<sup>7</sup>

*Benefits.* The decision to develop Orbitz is analogous to any firm's decision to sell its product or service instead of franchising it. Airlines, including founders and Charter Associates, expect that by increasing control over how their service is distributed, that they will lower their costs. Given the close relationship in the past between costs and fares, it is reasonable to expect that most, if not almost all, of the cost savings eventually

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<sup>7</sup> From Orbitz "Amended and Restated Airline Charter Associate Agreement."

will be passed on to travelers in lower fares.<sup>8</sup> The basis for this projection is that the intense competition in the airline industry consistently has translated cost reducing improvements in operations and innovations into lower fares.

Orbitz will also benefit travelers by providing them with a new distribution outlet that offers an exhaustive range of fares without the possibility of bias. Because competition from Orbitz will force other ticket distribution outlets to be more efficient and price competitive, travelers will benefit from Orbitz even if they do not use it.

*Potential Costs.* Because new competition is generally thought to be desirable, it is somewhat surprising that antitrust concerns have surfaced about Orbitz. One concern is that the airline owners of Orbitz will engage in price collusion that will eventually lead to fare increases. A second concern is that the owners will engage in collective action (a group boycott) to withhold information from the so-called “neutral navigators” (such as Expedia.com and Travelocity.com), which will also enable them to raise fares because travelers will not always be aware of the lowest fares available.

The U.S. Justice Department has raised concerns about fare collusion in the airline industry in the past. After one inquiry, the airlines signed a consent decree with the Justice Department where they agreed not to announce the ending dates of their fare

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<sup>8</sup> For evidence of the strong alignment between cost and fare reductions see Steven A. Morrison and Clifford Winston, “Regulatory Reform in Intercity Transportation,” in *Essays in Transportation Economics and Policy: A Handbook in Honor of John R. Meyer*, Jose Gomez-Ibanez, William B. Tye, and Clifford Winston, editors (Brookings, 1999).

promotions. There is no danger that Orbitz will present a similar concern because the new venture will list actual fares rather than planned fares. Furthermore, Orbitz will not give airlines access to fare information that they do not already have through Airline Tariff Publishers, the clearinghouse for airline fares. Finally, the low profit margin of the airline industry attests to its competitiveness and indicates that it is highly unlikely that carriers will be able to use any mechanism to maintain collusive agreements that raise fares.<sup>9</sup>

Collusive action against other distributors is also very unlikely. Although Orbitz is motivated by the desire of the founding carriers to lower their costs, these carriers value the additional business that other distribution outlets can generate and have little incentive to eliminate these outlets. Nonetheless, it has been alleged that Orbitz founders may only allow certain E-fares to be available on Orbitz.<sup>10</sup> It is difficult to understand why carriers would want to withhold such fares from sites offering similar terms, especially because these fares represent such a small share of their revenues. At a

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<sup>9</sup> During the 1990s, which witnessed both very poor and very good performance by the U.S. airline industry relative to its historical record, operating profit margin (profit after interest and taxes expressed as a percentage of operating revenue) ranged from -6.1% to 4.7% and averaged 0.2%. These figures are based on data from the Air Transport Association.

<sup>10</sup> E-fares are deeply discounted fares offered for sale on airline web sites 2-3 days prior to the flight's departure. The low prices reflect the "distressed inventory" nature of the available seats that would likely depart empty if not sold at a deep discount. The U.S. Department of Transportation reports that E-fares amount to less than three percent of on-line ticket sales and less than one-tenth of one percent of airline total sales. (Statement of Kenneth Mead before the Senate Commerce, Science, and Transportation Committee, Internet Sale of Airline Tickets, July 20, 2000, CR-2000-111.)

minimum, one would expect founding carriers to continue to put these fares on their own websites, as is current practice.

There is, however, a contractual matter that should be raised. In return for booking fee reductions, charter associates must provide in-kind promotional support to Orbitz. Charter associates have a wide variety of options as to how they meet this obligation, including such options as ticket jacket notices, airport advertising, logos on napkins, and so on, which are essentially cost-free to the airline.

One of the wide variety of options available to associate airlines is the option (solely at the associate airline's discretion) to provide exclusive fares to Orbitz—an option that might well have negative cash impact on the airline because of foregone revenue. Although carriers' agreements with Orbitz are not exclusive—carriers may provide any fares they wish to any distribution channel—the option just noted is the subject of some controversy. Airlines receive more credit toward their in-kind promotional obligation for fares provided exclusively to Orbitz, less credit for fares available only through Orbitz and the carriers' own web sites, and no credit for fares also available through other distribution channels. It has been claimed by some that this provision may well have the effect of effectively breaking the non-exclusivity agreement that Orbitz has with charter associates. It thus raises the question of whether consumers would be harmed by this contractual arrangement.

We leave to others the question of whether any associate airline would choose an option that might well involve a negative cash impact on them, when there were a wide variety of alternatives available that would have virtually no negative cash impact. However, given the intensity of airline competition, even if there were a reduction in or elimination of other online competitors, it is difficult to see how Orbitz founders could take advantage of this by raising fares or hoping that travelers would be unaware of the lowest available fares. This is especially the case given the findings reported above about the minimal effects of CRS bias. It is also important to bear in mind that Orbitz's founders do not include all major U.S. carriers, especially Southwest Airlines. These carriers continue to develop their own web-sites and search engines and are capable of making their low fares widely known. Indeed, *Consumer Reports Travel Letter* advises "For best results, book through the web only after consulting with other sites; the airlines themselves (many offer exclusive deals on their own branded sites); or a travel agency that discloses any potential biases of its own."

### **Policy Issues**

Despite any persuasive theory or historical evidence, the concerns about Orbitz's potential anti-competitive effects have led to tentative proposals to regulate its behavior. For example, one proposal that has been floated would require any fares that are available to consumers through Orbitz to be also made available to every CRS system, even in the absence of equivalent financial considerations such as reduced booking costs.



Before assessing the potential social benefits of government intervention in the distribution of airline tickets, it is important to recognize that currently 70 percent of airline tickets are sold through conventional travel agencies, 20.7 percent through airlines' own reservation agents, 5 percent through online sales by travel agents, both conventional and (solely) web-based, and 4.3 percent through airlines' own web sites.<sup>11</sup> Although online sales are projected to grow rapidly over the next several years, this distribution is in its infancy and it is far from clear how it will develop. Just to consider a few possible scenarios: the majority of travelers may continue to prefer travel or carrier agents;<sup>12</sup> travelers may expand their use of carrier-specific web-sites such as Southwest's, United's, and others; the founders of Orbitz may find after a few years that they wish to sell their online service to a non-airline entity; or alternative search engines may develop to challenge the technology that Orbitz uses.<sup>13</sup> There is simply no basis *at this time* for concluding that any group of carriers could dominate airline ticket distribution and use their dominance to raise fares.

Without any evidence—even suggestive—of the incidence and costs of purely hypothetical anti-competitive behavior, it is premature and inadvisable for the government to intervene in a market. Premature regulation of Orbitz could raise its

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<sup>11</sup> Estimates for the year 2000 from *Testimony of the American Society of Travel Agents* before the U.S. Committee on Commerce, Science, and Technology, July 20, 2000.

<sup>12</sup> The American Society of Travel Agents says that consumers prefer to deal with travel agencies because they place greater trust in them than in other information sources.

<sup>13</sup> Indeed, two websites recently launched (qixo.com and farechase.com) use proprietary search engines to search airline and independent travel web sites looking for the lowest fares.

operating costs or discourage its innovations without providing any countervailing benefits. Policy makers should allow Orbitz to operate as planned and maintain vigilance as the online market develops. If Orbitz were to behave in an anti-competitive manner, such as a group boycott that violates the antitrust laws, it would not be difficult for the Justice Department to initiate an antitrust action, or for the Department of Transportation to mount an appropriate regulatory intervention, to address any future problem that may materialize.

But at this point, any thought of government intervention is clearly premature. This is the implicit, if not explicit, message of the Federal Trade Commission's recent decision not to challenge the automobile industry's development of Covisint, the planned automotive e-business trading exchange (B2B) supported by GM, Ford, Daimler-Chrysler, and other automobile companies. The FTC conducted an investigation of allegations similar to those that have been leveled at Orbitz and ultimately decided not to intrude. There is no justification at this time for Orbitz to be treated any differently.

## CURRICULUM VITAE

Steven A. Morrison  
Department of Economics, 301 LA  
Northeastern University  
Boston, Massachusetts 02115

(617) 373-2873 (Office)  
(617) 373-8650 (Fax)  
(617) 965-2123 (Home)  
sam1@neu.edu (E-mail)

[www.dac.neu.edu/economics/morrison](http://www.dac.neu.edu/economics/morrison) (Web site)

Age: 49

Marital Status: Married

Citizenship: United States

### Education

Ph.D. (Economics) 1979 University of California, Berkeley  
B.A. (High Honors, Economics) 1973 University of Florida

### Academic Appointments

since July 1982 Department of Economics, Northeastern University, Boston, Massachusetts; Professor, since July 1990 (on leave September 1996-June 1997); Associate Professor, July 1985-June 1990 (on leave September 1988-August 1990); Assistant Professor, September 1982-June 1985.

July 1979 to June 1982 Faculty of Commerce and Business Administration, University of British Columbia, Vancouver, British Columbia, Canada; Assistant Professor.

### Administrative Appointments

since July 1999 Chair, Department of Economics, Northeastern University, Boston, Massachusetts.

January 1998 to June 1999 Acting Chair, Department of Economics, Northeastern University, Boston, Massachusetts.

April 1995 to August 1996 Interim Vice Provost for Research and Graduate Education, Northeastern University, Boston, Massachusetts.

September 1992 to March 1995 Executive Officer, Department of Economics, Northeastern University, Boston, Massachusetts.

### Visiting/Temporary Appointments

September 1996 to June 1997 Kennedy School of Government, Harvard University, Cambridge, Massachusetts; Visiting Professor.

February 1994 to May 1994 Department of Civil and Environmental Engineering, Massachusetts Institute of Technology, Cambridge, Massachusetts; Lecturer.

March 1989 to August 1990 Economic Studies Program, The Brookings Institution, Washington, D.C.; Visiting Fellow.

September 1988 to February 1989 Department of Economics, London School of Economics, London, England; Academic Visitor.

### Editorial Boards

*Journal of Transport Economics and Policy*, Managing Editor since 1998; Editorial Board since 1996.

*Journal of Air Transport Management*, North American Editor since 1998.

### Panels

Committee Member, National Academy of Sciences, Transportation Research Board, Committee for a Study of Competition in the U.S. Airline Industry, 1998-1999. The resulting report is Transportation Research Board, *Entry and Competition in the U.S. Airline Industry: Issues and Opportunities*, Special Report 255, Washington, D.C., 1999.

### Publications

Books: *The Evolution of the Airline Industry*, (with C. Winston), Washington, D.C.: The Brookings Institution, 1995.

*The Economic Effects of Airline Deregulation*, (with C. Winston), Washington, D.C.: The Brookings Institution, 1986.

- Journal Articles:
- "Actual, Adjacent, and Potential Competition: Estimating the Full Effect of Southwest Airlines," *Journal of Transport Economics and Policy*, forthcoming.
  - "A \$20 Billion Misunderstanding," (with C. Winston), *Milken Institute Review*, 2, Third Quarter 2000, pp. 20-29.
  - "Fundamental Flaws of Social Regulation: The Case of Airplane Noise," (with C. Winston and T. Watson), *Journal of Law and Economics*, 42, October 1999, pp. 723-743.
  - "The Fare Skies: Air Transportation and Middle America," (with C. Winston), *Brookings Review*, Fall 1997, pp. 42-45.
  - "The Causes and Consequences of Airline Fare Wars," (with C. Winston), *Brookings Papers on Economic Activity: Microeconomics*, 1996, pp. 85-123.
  - "Airline Mergers: A Longer View," *Journal of Transport Economics and Policy*, 30, September 1996, pp. 237-250.
  - "The Value of Amtrak," *Journal of Law and Economics*, 33, October 1990, pp. 361-382.
  - "The Dynamics of Airline Pricing and Competition," (with C. Winston), *American Economic Review*, 80, May 1990, pp. 389-393. [Translated into Japanese and reprinted in *Kosokudoro to Jidosha*, 34, 1991, pp. 48-52.]
  - "Enhancing the Performance of the Deregulated Air Transportation System," (with C. Winston), *Brookings Papers on Economic Activity: Microeconomics*, 1989, pp. 61-112. [Translated into Japanese and reprinted in Toshihiko Hayashi, ed., *Koekijigyo to Kiseikamwa*, Tokyo: Toyokeizai Shimposha, 1990.] [Reprinted, in part, in Richard Layard and Stephen Glaister, eds., *Cost-Benefit Analysis*, 2nd edition, Cambridge: Cambridge University Press, 1994, pp. 375-395.]
  - "Airline Deregulation and Public Policy," (with C. Winston), *Science*, 245, 18 August 1989, pp. 707-711. [Reprinted in Subcommittee on Aviation, Committee on Public Works and Transportation, U.S. House of Representatives, *The Adequacy of Competition in the Airline Industry*, 101st Congress, First Session.]
  - "The Effects of Reforming the Regulation of U.S. Domestic Civil Aviation," (with K.J. Button), *Royal Bank of Scotland Review*, 158, June 1988, pp. 33-53.
  - "Air Safety, Deregulation, and Public Policy," (with C. Winston), *Brookings Review*, 6, Winter 1988, pp. 10-15.
  - "The Theory of Optimal Highway Pricing and Investment: Comment," *Southern Economic Journal*, 53, January 1987, pp. 779-782.
  - "The Equity and Efficiency of Runway Pricing," *Journal of Public Economics*, 34, October 1987, pp. 45-60.
  - "Empirical Implications and Tests of the Contestability Hypothesis," (with C. Winston), *Journal of Law and Economics*, 30, April 1987, pp. 53-66. [Reprinted in Tae Oum, et al., eds., *Transport Economics: Selected Readings*, Amsterdam: Harwood Academic Publishers, 1997, pp. 483-499.]
  - "Airline Deregulation in the United States," (with C. Winston), *Bell Atlantic Quarterly*, 4, Spring-Summer 1987, pp. 21-31.
  - "A Survey of Road Pricing," *Transportation Research*, 20A, March 1986, pp. 87-97.
  - "Voting and the Efficiency of Airport Runway Investment," *Transportation Research*, 19A, February 1985, pp. 59-64.
  - "Intercity Transportation Route Structures Under Deregulation: Some Assessments Motivated by the Airline Experience," (with C. Winston), *American Economic Review*, 75, May 1985, pp. 57-61.
  - "An Econometric Analysis of the Demand for Intercity Passenger Transportation," (with C. Winston), *Research in Transportation Economics*, 2, 1985, pp. 213-237.

"An Economic Analysis of Aircraft Design," *Journal of Transport Economics and Policy*, **18**, May 1984, pp. 123-143.

"Profitability and Fleet Age Profiles in the U.S. Airline Industry," *International Journal of Transport Economics*, **10**, December 1983, pp. 613-620.

"Hours of Operation Restrictions and Competition Among Retail Firms," (with R.J. Newman), *Economic Inquiry*, **21**, January 1983, pp. 107-114.

"Estimation of Long-Run Prices and Investment Levels for Airport Runways," *Research in Transportation Economics*, **1**, 1983, pp. 103-130.

"The Demand for Intercity Passenger Transportation: The Impact on the Bus Industry in a Changing Environment," (with C. Winston), in Transportation Research Forum, *Proceedings: Twenty-fourth Annual Meeting*, **24**, 1983, pp. 526-534.

"The Structure of Landing Fees at Uncongested Airports: An Application of Ramsey Pricing," *Journal of Transport Economics and Policy*, **16**, May 1982, pp. 151-159.

Chapters in Books: "The Remaining Role of Government Policy in the Deregulated Airline Industry," (with C. Winston) in *Deregulation of Network Industries: What's Next?*, Sam Peltzman and Clifford Winston, eds., Washington, D.C.: American Enterprise Institute and Brookings Institution, 2000.

"Regulatory Reform of U.S. Intercity Transportation," (with C. Winston) in J. Gomez-Ibanez, W. Tye, and C. Winston, eds., *Essays in Transportation Economics and Policy: A Handbook in Honor of John R. Meyer*, Washington, D.C.: Brookings Institution, 1999.

"Airline Services: The Evolution of Competition Since Deregulation," in Larry L. Duetsch, ed., *Industry Studies*, 2nd ed., Armonk, NY: M.E. Sharpe, 1998. [previous version published by Prentice-Hall, 1993.]

"Cleared for Takeoff: The Evolution of the Deregulated Airline Industry," (with C. Winston), in *The Annual Review of Travel*, New York: American Express, 1992.

"U.S. Domestic Aviation," in K.J. Button and D. Swann, eds., *The Age of Regulatory Reform*, Oxford: Oxford University Press, 1989.

Edited Volumes: *Transport Economics: Selected Readings*, Amsterdam: Harwood Academic Publishers, 1997, (coedited with Tae Oum, John Dodgson, David Hensher, Christopher Nash, Kenneth Small, and W.G. Waters II).

Book Reviews: Review of: Clinton V. Oster, John S. Strong, and C. Kurt Zorn, *Why Airplanes Crash: Aviation Safety in a Changing World*, in *Journal of Economic Literature*, March 1994, pp. 164-166.

Review of: Alan C. McKinnon, *Physical Distribution Systems*, in *Journal of Economic Literature*, **29**, June 1991, pp. 603-604.

Review of: Leon N. Moses and Ian Savage, eds., *Transportation Safety in an Age of Deregulation*, in *Journal of Economic Literature*, **29**, March 1991, pp. 122-123.

Review of: John R. Meyer and Clinton V. Oster, Jr., *Deregulation and the Future of Intercity Passenger Travel*, in *Journal of Economic Literature*, **26**, September 1988, pp. 1217-1218.

Review of: Rigas Doganis, *Flying Off Course: The Economics of International Airlines*, in *Logistics and Transportation Review*, **23**, December 1987, pp. 427-428.

"Opinion" Pieces: "Foul Regulatory Weather Grounds Airline Competition," (with C. Winston), *Wall Street Journal*, December 3, 1997; "High-Speed Rail a Mistake," *Boston Globe*, December 1, 1992; "Let's Just Raise the Price of Highway, Air Transportation to Equal its Real Cost," *Roll Call*, June 29, 1992; "Stormy Weather for the Airlines," (with C. Winston), *Boston Globe*, August 4, 1991; "Pricing the Crowds Off the Roads," *Boston Globe*, May 14, 1991; "Airline Deregulation," *TransLaw*, Fall 1990; "Yes: Slot System Yields Benefits," *The Public's Capital*, Fall 1990; "Californians Getting a Fair Deal on Air Travel," (with C. Winston), *Los Angeles Times*, June 17, 1990; "With Deregulation, Everybody Gains," (with C. Winston), *New York Times*, April 8, 1990; "Helping Airports Take Off," *New York Times*, March 16, 1990; "Airline Reregulation Won't Fly on Economic Basis," (with C. Winston), *Atlanta Journal and Constitution*, April 15, 1989; "Less Congestion Requires Higher Fees," (with C. Winston), *New York Times*, January 15, 1989.

### Presentations

Congressional  
and Other  
Testimony:

Committee on Transportation and Infrastructure, U.S. House of Representatives, Washington, D.C., 2000; Subcommittee on Antitrust, Business Rights, and Competition, Committee on the Judiciary, U.S. Senate, Washington, D.C., 2000; Subcommittee on Aviation, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, D.C., 1998; Subcommittee on Antitrust, Business Rights, and Competition, Committee on the Judiciary, U.S. Senate, Washington, D.C., 1998; Committee on the Judiciary, U.S. House of Representatives, Washington, D.C., 1997; Subcommittee on Transportation and Related Agencies, Committee on Appropriations, U.S. Senate, Washington, D.C., 1997; Subcommittee on Aviation, Committee on Transportation and Infrastructure, U.S. House of Representatives, Washington, D.C., 1997; National Commission to Ensure a Strong Competitive Airline Industry, Washington, D.C., 1993; Subcommittee on Transportation and Related Agencies, Committee on Appropriations, U.S. House of Representatives, Washington, D.C., 1993; Subcommittee on Water Resources, Transportation, and Infrastructure, Committee on Environment and Public Works, U.S. Senate, Washington, D.C., 1991; Subcommittee on Aviation, Committee on Public Works and Transportation, U.S. House of Representatives, Washington, D.C., 1991; Subcommittee on Aviation, Committee on Public Works and Transportation, U.S. House of Representatives, Washington, D.C., 1989.

Presentations at  
Meetings of  
Scholarly Societies:

Air Transportation Research Group, Vancouver, Canada, 1997; American Economic Association, New Orleans, 1997; Transportation Research Forum, San Antonio, 1996; Transportation and Public Utilities Group of the American Economic Association, San Francisco, 1996; Transportation and Public Utilities Group of the American Economic Association, Boston, 1994; Transportation Research Forum, New York, 1993; Eastern Economic Association, New York, 1992; Transportation and Public Utilities Group of the American Economic Association, New Orleans, 1992; Transportation Research Forum, New Orleans, 1991; American Economic Association, Atlanta, 1989; Transportation Research Forum, Williamsburg, 1989; World Conference on Transport Research, Yokohama, 1989; Association of American Geographers, Baltimore, 1989; American Economic Association, New York, 1988; Transportation and Public Utilities Group of the American Economic Association, Chicago, 1987; Canadian Transportation Research Forum, Toronto, 1985; American Economic Association, Dallas, 1984; Canadian Economics Association, Guelph, 1984; Canadian Transportation Research Forum, Jasper, 1984; Transportation Research Forum, Washington, D.C., 1983; American Economic Association, New York, 1982; Western Economic Association, Los Angeles, 1982; Canadian Economics Association, Ottawa, 1982; Canadian Transportation Research Forum, Montreal, 1982; Canadian Economics Association, Halifax, 1981.

**Presentations at Universities:**

University of British Columbia, 2000; Wayne State College, 1999; Embry-Riddle Aeronautical University, 1999; Harvard University, 1997; Harvard University, 1996; University of Virginia, 1996; MIT, 1994; Harvard University, 1994; University of Chicago, 1993; Harvard University, 1993; MIT, 1992; Emory University, 1992; Harvard University, 1992; Harvard University, 1991; Queen's University (Canada), 1990; University of Wisconsin, Eau Claire, 1989; Virginia Polytechnic Institute, 1989; University of St. Andrews, 1989; University of Aberdeen, 1989; London School of Economics, 1989; University of Exeter, 1988; University of Liverpool, 1988; Loughborough University, 1988; University of California, Irvine, 1988; Université de Montréal, 1988; Harvard University, 1986; University of Maryland, 1986.

**Other Presentations:**

British Columbia Aviation Council Conference, Whistler, British Columbia, 2000; American Enterprise Institute and Brookings Institution, Washington, D.C., 1999; Transportation Research Board, Washington, D.C., 1998; National Economic Council, Washington, D.C., 1998; Brookings Institution, Washington, D.C., 1996; Bombardier Regional Aircraft Division, Aylmer, Quebec, 1996; Sumitomo Life Research Institute, Tokyo, 1995; Economic Planning Agency, Government of Japan, Tokyo, 1995; Charles River Associates, Boston, 1994; U.S. Department of Justice, Washington, D.C. 1993; Smithsonian Institution, Washington, D.C., 1993; Transportation Research Board, Washington, D.C., 1993; Alliance for Democracy and Human Rights in Nepal, New York, 1992; U.S. Agency for International Development Mission, Kathmandu, Nepal, 1992; Royal Commission on National Passenger Transportation, Ottawa, 1991; U.S. General Accounting Office, Washington, D.C., 1990; Air Transport Association, Washington, D.C., 1990; Citizens for a Sound Economy, Washington, D.C., 1990; Price Waterhouse/McDermott, Will and Emery, Washington, D.C., 1990; Brookings Institution, Washington, D.C., 1990; Resources for the Future, Washington, D.C., 1990; Transportation Research Board, Washington, D.C., 1990; U.S. Department of Transportation, Washington, D.C., 1989; Washington Journalism Center, Washington, D.C., 1989; U.S. General Accounting Office, Washington, D.C., 1989; National Conference of State Legislatures, Senior Fiscal Analysts' Seminar, Fort Lauderdale, 1989; General Aviation Manufacturers Association, Washington, D.C., 1989; Transportation Research Board, Washington, D.C., 1989; IASI-CNR, Rome, 1989; Brookings Institution, 1988; U.S. Department of Transportation, Transportation Systems Center, Cambridge, 1988; Institute for International Research, Washington, D.C., 1988; Citizens for a Sound Economy, Washington, D.C., 1988; U.S. Department of Transportation, Transportation Systems Center, Cambridge, 1988; Cato Institute, Washington, D.C., 1986.

**Teaching**

Courses taught at Northeastern University (NU), the University of British Columbia (UBC), Massachusetts Institute of Technology (MIT), and Harvard's Kennedy School of Government (KSG):

Principles of Economics (UBC, NU)  
Microeconomic Theory (NU, undergraduate and graduate)  
Applied Microeconomic Analysis (KSG, graduate)  
Introduction to Probability and Statistics (UBC)  
Transportation Economics (UBC, NU, undergraduate and graduate; MIT, graduate)  
Public Policy in Transportation and Public Utilities (UBC)  
Air Transportation (UBC)  
Urban Economics (NU, undergraduate and graduate)

**Consultancies**

U.S. Department of Transportation; U.S. Federal Aviation Administration; U.S. Federal Highway Administration; U.S. Department of the Interior (National Park Service); Government of Canada; Government of Japan; Government of Nepal (through USAID); Organization for Economic Cooperation and Development; Consumers' Association of Canada; National Business Travel Association; City of Brook Park, Ohio; (Seattle) Airport Communities Coalition; Alamo Rent A Car; Galileo International; Orbitz; American Airlines; Northwest Airlines; United Airlines; US Airways; Southwest Airlines; Virgin Atlantic Airways

Fellowships, Honors, and Awards

Recipient of the Transportation Research Forum Prize for the best aviation paper, 1996, paper entitled “The Causes and Consequences of Airline Fare Wars,” (coauthored with C. Winston)

Honorable Mention, American Express Annual Review of Travel International Essay Competition, 1992, paper entitled “Cleared for Takeoff: The Evolution of the Deregulated Airline Industry,” (coauthored with C. Winston)

Recipient of the Transportation Research Forum Prize for the best paper on intercity bus transportation, sponsored by the American Bus Association, 1983, paper entitled “The Demand for Intercity Passenger Transportation: The Impact on the Bus Industry in a Changing Environment,” (coauthored with C. Winston)

Phi Beta Kappa

Memberships and Other Information

American Economic Association

Transportation and Public Utilities Group of AEA (Vice Chair, 1995; Chair, 1996; Executive Committee, 1997–1999)

Transportation Research Forum

Participant, Management Development Program, Harvard University Graduate School of Education, June 1996



## CURRICULUM VITAE

June 2000

Name: Clifford Winston

Address: The Brookings Institution  
1775 Massachusetts Avenue N.W.  
Washington DC, 20036

Telephone: Home - (703) 527-7731  
Office - (202) 797-6173

Fax: Office - (202) 797-2973

E-mail: CWinston@Brook.edu

### EDUCATION

<u>Institution</u>	<u>Major</u>	<u>Degree</u>
U.C. Berkeley	Economics	A.B. 1974
London School of Economics	Economics	MSc 1975
U.C. Berkeley	Economics	Ph.D. 1979

### PROFESSIONAL EXPERIENCE

The Brookings Institution, Economic Studies Program, Senior Fellow, since 1986;  
Research Associate, 1984-1986.

Co-editor, *Brookings Papers on Economic Activity: Microeconomics*, since 1987.

Massachusetts Institute of Technology, Transportation Systems Division, Department  
of Civil Engineering, Associate Professor, 1984; Assistant Professor, 1979-1984.

## PUBLICATIONS

### Books:

*The Economic Effects of Airline Deregulation*, The Brookings Institution, Washington, DC, 1986 (with S. Morrison).

*Blind Intersection? Policy and the Automobile Industry*, The Brookings Institution, Washington, DC, 1987 (with others).

*Liability: Perspectives and Policy*, The Brookings Institution, Washington, DC, 1988 (co-edited with R. Litan).

*Road Work: A New Highway Pricing and Investment Policy*, The Brookings Institution, Washington, DC, 1989 (with K. Small and C. Evans).

*The Economic Effects of Surface Freight Deregulation*, The Brookings Institution, Washington, DC, 1990 (with T. Corsi, C. Grimm, and C. Evans).

*The Evolution of the Airline Industry*, The Brookings Institution, Washington, DC, 1995 (with S. Morrison).

*Alternate Route: Toward Efficient Urban Transportation*, The Brookings Institution, Washington, DC, 1998 (with C. Shirley).

*Essays in Transportation Economics and Policy: A Handbook in Honor of John R. Meyer*, The Brookings Institution, Washington, DC, 1999 (co-edited with Jose A. Gomez-Ibanez and William B. Tye.)

*Deregulation of Network Industries: What's Next?*, AEI-Brookings Institution, Washington, DC, 2000 (co-edited with Sam Peltzman).

### Articles:

"A Disaggregate Model of the Demand for Intercity Freight Transportation," *Econometrica*, July 1981.

"A Multinomial Probit Model of the Demand for Domestic Ocean Container Service," *Journal of Transport Economics and Policy*, September, 1981.

"The Welfare Effects of ICC Rate Regulation Revisited," *Bell Journal of Economics*, Spring, 1981.

"Passing on the Monopoly Overcharge: The Welfare Implications," *Pennsylvania Law Review*, June, 1981 (with P. Viton).

"Identification of Dependent Probit Models: A Simplified Approach," *Economics Letters*, 1981.

"Potential Benefits of Rail Mergers: An Econometric Analysis of Network Effects on Service Quality," *Review of Economics and Statistics*, February, 1983 (with R. Harris).

"Costs, Technology and Productivity in the U.S. Automobile Industry," *Bell Journal of Economics*, Spring, 1983 (with A. Friedlaender and D. Wang).

"The Demand for Freight Transportation: Models and Applications," *Transportation Research*, November, 1983.

"Predatory Capacity Expansion in a Deregulated Motor Carrier Industry," *Research in Transportation Economics*, Volume 1, 1983 (with R. Ericson).

"A Numerical Analysis of the Impact of Uncertain Demand and Varying Risk Preferences on the Pricing and Capacity Decisions of Transportation Firms: The Case of Airlines," *Transportation Research*, December 1983 (with W. Powell).

"Consumer Demand for Automobile Safety," *American Economic Review Papers and Proceedings*, May 1984 (with F. Mannering).

"An Econometric Analysis of the Demand for Intercity Passenger Transportation," *Research in Transportation Economics*, Volume 2, 1985 (with S. Morrison).

"Conceptual Developments in the Economics of Transportation: An Interpretive Survey," *Journal of Economic Literature*, March, 1985.

"Joint Estimation of Freight Transportation Decisions under Non-Random Sampling," in A. Daughety ed., *Analytical Studies in Transport Economics*, Cambridge University Press, 1985 (with D. McFadden and A. Boersch-Supan).

"Intercity Transportation Route Structures Under Deregulation: Some Assessments Motivated by the Airline Experience," *American Economic Review Papers and Proceedings*, May, 1985 (with S. Morrison).

"A Dynamic Empirical Analysis of Household Vehicle Ownership and Utilization," *Rand Journal of Economics*, Summer, 1985 (with F. Mannering).

"Efficient Pricing and Investment Solutions to Highway Infrastructure Needs," *American Economic Review Papers and Proceedings*, May, 1986 (with K. Small).

"Welfare Effects of Marginal Cost Taxation of Motor Freight Transportation: A Study of Infrastructure Pricing," in H. Rosen ed. *NBER Conference on State and Local Public Finance*, University of Chicago Press, 1986 (with K. Small).

"Empirical Implications and Tests of the Contestability Hypotheses," *Journal of Law and Economics*, April 1987 (with S. Morrison).

"Air Safety, Deregulation, and Public Policy," *Brookings Review*, Winter 1988 (with S. Morrison).

"Optimal Highway Durability," *American Economic Review*, June 1988 (with K. Small).

"Enhancing the Performance of the Deregulated Air Transportation System," *Brookings Papers on Economic Activity, Microeconomics*, 1989 (with S. Morrison).

"Airline Deregulation and Public Policy," *Science*, August 1989 (with S. Morrison).

"The Dynamics of Airline Pricing and Competition," *American Economic Review Papers and Proceedings*, May, 1990 (with S. Morrison).

"Efficient Transportation Infrastructure Policy," *Journal of Economic Perspectives*, Winter, 1991.

"Brand Loyalty and the Decline of American Automobile Firms," *Brookings Papers on Economic Activity, Microeconomics*, 1991 (with F. Mannering).

"Foreclosure of Railroad Markets: A Test of Chicago Leverage Theory," *Journal of Law and Economics*, October, 1992 (with C. Grimm and C. Evans).

"Public Infrastructure," in H. Aaron and C. Schultze eds., *Setting Domestic Priorities: What Can Government Do?* The Brookings Institution, 1992 (with B. Bosworth).

"The Consumer Welfare Effects of Liability for Pain and Suffering: An Exploratory Analysis," *Brookings Papers on Economic Activity, Microeconomics*, 1993 (with J. Calfee).

"Economic Deregulation: Days of Reckoning for Microeconomists," *Journal of Economic Literature*, September 1993.

"Explaining Regulatory Policy," *Brookings Papers on Economic Activity, Microeconomics*, 1994 (with R. Crandall).

"Automobile Air Bags in the 1990s: Market Failure or Market Efficiency?," *Journal of Law and Economics*, October, 1995 (with F. Mannering).

"Causes and Consequences of Airline Fare Wars," *Brookings Papers on Economic Activity, Microeconomics*, 1996 (with S. Morrison).

"Air Transportation and Middle America," *Brookings Review*, Fall, 1997 (with S. Morrison).

"U.S. Industry Adjustment to Economic Deregulation," *Journal of Economic Perspectives*, Summer 1998.

"The Value of Automobile Travel Time: Implications for Congestion Policy," *Journal of Public Economics*, July 1998 (with J. Calfee).

"Fundamental Flaws of Social Regulation: The Case of Airplane Noise," *Journal of Law and Economics*, October 1999 (with S. Morrison and T. Watson).

"You Can't Get There From Here: Government Failure in U.S. Transportation," *Brookings Review*, Summer 1999.

"Econometric Issues in Estimating Consumer Preferences from Stated Preference Data: A Case Study of the Value of Automobile Travel Time," under review (with J. Calfee and R. Stempki).

"An Exploratory Analysis of the Growth of Automobile Leasing in the United States," under review (with F. Mannering and W. Sharkey).

## TEACHING

Courses taught at Massachusetts Institute of Technology:

- Applied Microeconomic Theory (undergraduate and graduate)
- Transportation Economics (graduate)
- Project Evaluation (graduate)
- Public Policy Toward Industry (graduate)
- Applied Econometrics (graduate)
- Advanced Travel Demand Analysis (graduate)

## CURRICULUM VITAE

Robert E. Litan

### Home Address

3 Golden Crest Court  
Rockville, Maryland 20854  
301/424-3722

### Office Address

The Brookings Institution  
1775 Massachusetts Ave, N.W.  
Washington, D.C. 20036  
Tel: 202/797-6120  
Fax: 202/797-6181 or 4362  
E-mail: rlitan@brook.edu

### Employment

1996- Vice President and Director, Economic Studies Program and Cabot Family Chair in Economics, The Brookings Institution

Responsible for supervising the Institution's economic research program, its 22 scholars and support staff, and for administering and raising funds for a \$5.5 million annual research program; continuing research on financial institutions, trade, and legal and economic issues relating to the information revolution

Co-Editor, The Brookings-Wharton Papers on Financial Services (1997 -)

Co-Editor, The World Bank-Brookings Papers on Emerging Markets Finance (1998 -)

Co-Director, AEI-Brookings Joint Center on Regulatory Studies (1998 -)

1996- Special Consultant, Economists, Inc. (Economic consulting firm)

1995-96 Associate Director, U.S. Office of Management Budget -- Responsible for budgets and clearance of policy for five cabinet agencies (Commerce, HUD, Justice, Treasury and Transportation) and most of the independent agencies of the U.S. Government (requiring supervision of approximately 70 professional staff)

1993-95	<u>Deputy Assistant Attorney General, Antitrust Division, Department of Justice</u> -- Supervision of approximately 150 attorneys and paralegals in non-merger civil antitrust investigations; Developing DOJ policy on regulatory issues; Active participation in the development of the Administration's policies on telecommunications, trade and various regulatory issues
1984-1993	<u>Senior Fellow, Economic Studies Program</u> ; Director (1987-92), Center for Economic Progress and Employment; and Director (1992-93), Center for Law, Economics, and Politics, The Brookings Institution, Washington, D.C., -- Specialist in financial institutions; international trade; and regulatory policy.
1982-90	Powell, Goldstein, Frazer & Murphy, law firm, Washington, D.C.: Senior Associate (1982-84); Partner (1984); Of Counsel (1984-90) -- Attorney specializing in administrative law, antitrust, banking, energy, international trade, and legal issues generally involving law and economics.
1979-1982	Arnold & Porter, law firm, Washington, D.C., Associate.
1977-1979	President's Council of Economic Advisers, Executive Office of the President, Washington, D.C. Regulatory and Energy Specialist; principal staff for the Regulatory Analysis Review Group; handled selected legal issues for the Council.
1974-1976	Peabody, Rivlin, Lambert & Meyers - summer legal associate.
1972-1973	The Brookings Institution, Washington, D.C. - research assistant to Dr. Arthur M. Okun.
1970-1971	Peat, Marwick, Mitchell & Co., Wichita, Kansas - two summers as an intern tax accountant.

### Teaching

1993	Taught principles of Western banking to Russian bankers (under a Treasury Department grant administered by KPMG Peat Marwick)
1989-90 1986-87	Yale Law School - Visiting Lecturer in Law (Banking).
1976-1977	Yale University - Lecturer in Economics (taught Economics and Law; and Elementary Macroeconomics; both large lecture courses).

1975-1976                Yale University - Instructor in Economics (taught two sections of Elementary Micro and Macroeconomics).

### Consultancies

2000                Arbitrator in electric power transmission dispute (East Coast v. PJM); Federal Deposit Insurance Corporation (expert witness in thrift goodwill cases)

1999                American Bankers Association (prepared report on ATM fees); Federal Deposit Insurance Corporation (expert witness in thrift goodwill cases); World Bank (prepared background paper on global finance for the World Development Report)

1998                Main Writer for the Report of the President=s Commission to Study Capital Budgeting

1996-97            U.S. Department of the Treasury (prepared Congressionally mandated report on the future of the financial services industry and its regulation); Antitrust Division of the Department of Justice (on telecommunications issues)

1993                Federal Home Loan Bank of San Francisco (prepared report on the future role of the Federal Home Loan Bank System)

1990                Financial Institutions Subcommittee of the House Banking Committee (prepared report on the condition of the Federal Deposit Insurance Corporation with James R. Barth and R. Dan Brumbaugh, Jr.).

1987-92            Oxford Analytica (British News Service) -- regular contributor of reports on the U.S. banking and thrift industries.

1987                Senate Judiciary Committee -- organized hearings for the Chairman on antitrust and competitiveness issues, authored report on antitrust policy for the Committee.

1985-89            Institute for Liberty and Democracy, Lima Peru - legal and economic consulting on deregulation matters generally, including financial institutions issues.

1976-77            National Academy of Sciences - consultant to the Modeling Resources Group of the Committee on Nuclear and Alternative Energy Systems (CONAES).

(Separate listing of expert witness assignments and other project consultancies available on request.)



### Advisory Boards or Boards of Directors

- 1999- Board of Advisers, Committee for Economic Development
- 1997-98 Chairman, National Research Council Committee on Disaster Loss Estimation (And co-author of The Impacts of Natural Disasters: A Framework for Loss Estimation).
- 1996- Member, Shadow Financial Regulatory Committee; Co-Chairman as of May 1998
- 1996 Department of Defense, Defense Sciences Board, Member of Task Force on Vertical Integration in the Defense Industry
- 1993-94 Department of Defense, Defense Sciences Board, Member of Task Force on Mergers within the Defense Industry
- 1991-93 Chairman, Editorial Advisory Board, Public Policy Studies Series for the Insurance Information Institute.
- 1991-92 Presidential-Congressional Commission on the Causes of the Savings and Loan Crisis (Member).
- 1988-90 Conference Board of Canada Financial Institutions Group (Advisory Board).
- 1988-90 Foundation for Change (Board of Directors).
- 1988-89 Member of Advisory Board to Office of Technology Assessment Study on Technological Change in Banking and Securities Markets.

### Education

- 1987 Yale University: Ph.D. in Economics. Dissertation: An Economic Inquiry Into the Expansion of Bank Powers. (Dissertation Committee: Professors Richard Levin, Merton Peck and James Tobin).
- 1977 Yale University: J.D. (1977), Felix S. Cohen Prize for best essay in legal philosophy; Extra-curricular Activities: Yale Legislative Services, Barrister's Union; Employment, Consulting and Teaching 1973-1977 (see above).

1976 Yale University: M. Phil. in Economics, Distinction in Ph.D. oral examinations (international trade and finance, industrial organization).

1968-72 Wharton School of Finance and Commerce, University of Pennsylvania: B.S. Economics, summa cum laude (Valedictorian); Major - Finance; Minors - Accounting, Statistics and Mathematics.

Honors and Awards: Thouron Fellowship for Graduate Study in Great Britain (which was not used); Royal Society of Arts Silver Medal (National award given to selected outstanding graduating seniors in the U.S.); Class of 1946 Award (given by the University to an outstanding graduating senior); William D. Gordon Award (given by the Wharton School to the graduating senior with the highest scholastic average); Beta Gamma Sigma Award (given by the Wharton School to the graduating senior with the highest scholastic average); Albert A. Berg Scholarship Award, 1971, 1972, (given each year by the Wharton Faculty to an outstanding upperclassman in the Wharton School).

Extra-curricular Activities: Chairman, Activities Council (major student government body); Executive Editor of Wharton Account (major undergraduate business magazine); Vice-President of Debate Council; 2 years in intercollegiate debate; President, Beta Gamma Sigma; Friars Senior Honor Society; Beta Alpha Psi; Employment in Electrical Engineering Library (4 years).

## Publications

Books

None of Your Business: World Data Flows, Electronic Commerce, and The European Privacy Directive (with Peter Swire), Brookings (1998)

Globophobia: Confronting Fears About Open Trade (with Gary Burtless, Robert Lawrence and Robert Shapiro), Brookings, Progressive Policy Institute, and the Twentieth Century Fund, 1998

American Finance for the 21st Century (with the assistance of Jonathan Rauch), U.S. Department of the Treasury (1997) and Brookings (1998)

Going Digital! (with William Niskanen), Brookings Institution Press and the Cato Institute (1998)

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- Regular speeches, seminars on banking, international trade and regulatory issues before academic, government and other professional audiences.

\* \* \* \* \*

Who's Who in America  
Who's Who in the East  
Who's Who Among American Lawyers  
Member, Council on Foreign Relations

Date of Birth: May 16, 1950

Married (Avivah); Son (Ariel Daniel); Daughter (Alisa Michelle)

### **CERTIFICATE OF SERVICE**

I hereby certify that on this 23<sup>rd</sup> day of October 2000, a copy of the foregoing Reply Comments of Orbitz, L.L.C. was served by mail or by hand on the parties named below:

**Aer Lingus**

c/o Harold E. Mesirow  
Robins, Kaplan, Miller & Ciresi LLP  
1801 K Street, N.W.  
Suite 1200  
Washington, DC 20006

**Aeromexico**

c/o William C. Evans  
Verner, Liipfert, Bernhard,  
McPherson and Hand  
901 15<sup>th</sup> Street, N.W.  
Suite 700  
Washington, DC 20005

**Air Carrier Association of America**

c/o Edward P. Faberman  
Michelle M. Faust  
Unagretti & Harris  
1500 K Street, N.W.  
Suite 250  
Washington, DC 20005

**Air France**

c/o Michael F. Goldman  
Silverberg, Goldman & Bikoff LLP  
Georgetown Place  
1101 30<sup>th</sup> Street, N.W.  
Suite 120  
Washington, DC 20007

**Air Jamaica**

c/o George U. Carneal  
Hogan & Hartson LLP  
Columbia Square  
555 13th Street N.W.  
Washington, DC 20004

Ray A. Mundy

Executive Director

**Airport Ground Transportation  
Association**

5320 Riverbriar Road  
Knoxville, TN 37919

**Alaska Airlines**

c/o Marshall S. Sinick  
James V. Dick  
Squire, Sanders & Dempsey LLP  
1201 Pennsylvania Ave., N.W.  
Suite 500  
Washington, DC 20004

Francesco Gallo

Comptroller, North America

**Alitalia Airlines**

666 Fifth Avenue  
New York, NY 10103

**Aloha Airlines**

c/o Marshall S. Sinick  
Squire, Sanders & Dempsey LLP  
1201 Pennsylvania Ave., N.W.  
Suite 500  
Washington, DC 20004

**Amadeus Global Travel Distribution**

c/o David H. Coburn  
Carol R. Gosain  
Steptoe & Johnson LLP  
1330 Connecticut Avenue, N.W.  
Washington, DC 20036

**America West Airlines**

c/o Joanne W. Young  
David M. Kirstein  
Alan F. Enslen  
Baker & Hostetler LLP  
1050 Connecticut Avenue, N.W.  
Suite 1100  
Washington, DC 20036

Carl B. Nelson, Jr.  
Associate General Counsel  
**American Airlines, Inc.**  
1101 17th Street, N.W.  
Suite 600  
Washington, DC 20036

Albert A. Foer  
President  
**American Antitrust Institute**  
2919 Ellicott St., N.W.  
Washington, DC 20008

Sarah Wynn  
Group Counsel  
**American Express Travel Related  
Services Company, Inc.**  
2000 Vesey Street  
New York, NY 10285

Paul M. Ruden  
Senior Vice President  
**American Society of Travel Agents, Inc.**  
1101 King Street  
Alexandria, VA 22314

**American Trans Air**  
c/o Marshall S. Sinick  
Squire, Sanders & Dempsey LLP  
1201 Pennsylvania Avenue, N.W.  
Suite 500  
Washington, DC 20004

Susan Pilralidas  
Vice President, Public Affairs  
**American Automobile Association**  
1440 New York Avenue, N.W.  
Suite 200  
Washington, DC 20005

Kathleen Gordon  
**Amtrak National Railroad Passenger  
Corporation**  
400 North Capitol Street, N.W.  
Washington, DC 20001

A. W. Teffaha  
**Arab Air Carriers Organization**  
P.O. Box 13-5468  
Beirut, Lebanon

**Association of Asia Pacific Airlines**  
c/o Jon F. Ash  
Charles R. Chambers  
Global Aviation Associates, Ltd.  
1800 K Street, N.W.  
Suite 1104  
Washington, DC 20006

Sefik Yuksel  
General Manager Trade & Social Affairs  
**Association of European Airlines**  
350 Avenue Louise  
Brussels, Belgium

Nancy Linares  
President  
**Association of Retail Travel Agents**  
501 Darby Creek Road  
Suite 47  
Lexington, KY 40509

Darryl Jenkins  
**The Aviation Foundation**  
3712 Madison Lane  
Falls Church, VA 22041



Bruce E. Cunningham  
**Bauer & Cunningham, Inc.**  
Two Moonvine  
The Woodlands, TX 77380

Paul C. Jasinski  
General Counsel, Americas  
James B. Blaney  
Senior Counsel, Americas  
**British Airways**  
75-20 Astoria Blvd.  
Jackson Heights, NY 11370

Hershel Kamen  
Vice President  
International and Regulatory Affairs  
**Continental Airlines, Inc.**  
1600 Smith Street  
Mail Code: HQSGV  
Suite 831F  
Houston, TX 77002

**Continental Airlines**  
c/o R. Bruce Keiner, Jr.  
Lorraine B. Halloway  
Crowell & Moring LLP  
1001 Pennsylvania Avenue, N.W.  
Washington, DC 20004

Mark Silbergeld  
Co-Director  
**Consumers Union**  
1666 Connecticut Avenue, N.W.  
Suite 310  
Washington, D.C. 20009

**Delta Air Lines**  
c/o Robert E. Cohn  
Alexander Van der Bellen  
Shaw Pittman  
2300 N Street, N.W.  
Washington, DC 20037

**EgyptAir**  
c/o Constance O'Keefe  
Boros & Garofalo  
1201 Connecticut Avenue, N.W.  
Suite 550  
Washington, DC 20036

**Emirates Airlines**  
c/o R. Tenney Johnson  
2121 K Street, N.W.  
Suite 800  
Washington, DC 20037

Andre Auer  
President  
**European Civil Aviation Conference**  
3 bis, Villa Emile Bergerat  
92522 Neuilly-sur-Seine Cedex  
France

His Excellency Guenter Burghardt  
Ambassador of the European Union  
**Delegation of the European Commission**  
2300 M Street, N.W.  
Washington, DC 20037

Mark S. Britton  
Senior Vice President and General Counsel  
**Expedia, Inc.**  
13810 SE Eastgate Way  
Suite 400  
Bellevue, WA 98005

**Marshall A. Fein, Esq.**  
1323 Hallmark Drive  
San Antonio, TX 78216

Arthur T. Voss  
Vice-President and General Counsel  
**Frontier Airlines, Inc.**  
12015 East 46<sup>th</sup> Avenue  
Denver, CO 80239

**Galileo International**

c/o Carolyn F. Corwin  
David W. Addis  
Covington & Burling  
1201 Pennsylvania Avenue, N.W.  
Washington, DC 20044

Theodore Knappen  
Government Affairs Representative  
**Greyhound Lines, Inc.**  
1001 G Street, N.W.  
Suite 400 East  
Washington, DC 20001

Thomas P. Cooper  
Vice President, Legal Affairs  
**Gulfstream International Airlines, Inc.**  
P.O. Box 660777  
Miami Springs, FL 33266

**Horizon Air**

c/o Marshall S. Sinick  
James V. Dick  
Squire, Sanders & Dempsey LLP  
1201 Pennsylvania Ave., N.W.  
Suite 500  
Washington, DC 20004

**Icelandair**

c/o Joanne W. Young  
Baker & Hostetler LLP  
Washington Square  
1050 Connecticut Avenue, N.W.  
Suite 1100  
Washington, DC 20036

Antonella Pianalto  
Executive Director  
**Interactive Travel Services Association**  
1001 G Street, N.W.  
Suite 900 East  
Washington, DC 20001

Paul V. Mifsud  
Vice President, Government & Legal  
Affairs, U.S.

**KLM Royal Dutch Airlines**

1201 Pennsylvania Avenue, N.W.  
Washington, DC 20004

**Korean Air Lines**

c/o James L. Devall  
Zuckert, Scoutt & Rasenberger  
888 17<sup>th</sup> Street, N.W.  
Washington, DC 20006

**Lanyon, Ltd.**

c/o Richard J. Fahy, Jr.  
1800 Diagonal Road  
Suite 600  
Alexandria, VA 22314

**Large-Agency CRS Coalition**

c/o Mark Pestronk  
4041 University Drive  
Suite 450  
Fairfax, VA 22030

Arthur J. Molins  
General Counsel North America  
**Lufthansa German Airlines**  
1640 Hempstead Turnpike  
East Meadow, NY 11554

**Lyn-Lea Travel Corp.**

c/o Stephen Gardner  
1845 Woodall Rogers Freeway  
Dallas, Texas 75201

**Midwest Agents Selling Travel**

15 Spinning Wheel Road  
Suite 336  
Hinsdale, IL 60521

**Midwest Express Airlines**

c/o Robert P. Silverberg  
Silverberg, Goldman & Bikoff, L.L.P.  
1101 30th Street, N.W.  
Suite 120  
Washington, DC 20007

Marianne McInerney  
**National Business Travel Association**  
1650 King Street  
Suite 401  
Alexandria, VA 22314

Elliott M. Seiden  
Vice President, Law and  
Government Affairs  
Megan Rae Rosia  
Associate General Counsel  
**Northwest Airlines, Inc.**  
901 15th Street, N.W.  
Suite 310  
Washington, DC 20005

**OAG Worldwide**  
c/o Joanne W. Young  
David M. Kirsten  
Baker & Hostetler LLP  
1050 Connecticut Ave, N.W.  
Suite 1100  
Washington, DC 20036

**Pan American Airways**  
c/o Aaron Goerlich  
Boros & Garofalo, P.C.  
1201 Connecticut Avenue, N.W.  
Suite 550  
Washington, DC 20036

**Donald L. Pevsner, Esq.**  
1765 East Riviera Drive  
Merritt Island, FL 32952

**Qantas Airways**

c/o James V. Dick  
Squire, Sanders & Dempsey, LLP  
1201 Pennsylvania Ave., N.W.  
Suite 500  
Washington, DC 20004

Hal F. Rosenbluth  
Chairman and CEO  
**Rosenbluth International, Inc.**  
2401 Walnut Street  
Philadelphia, PA 19103

**Royal Jordanian Airlines**

c/o Joanne W. Young  
Baker & Hostetler LLP  
1050 Connecticut Ave, N.W.  
Suite 1100  
Washington, DC 20036

Sterling L. Miller  
Senior Managing Attorney  
**Sabre, Inc.**  
4255 Amon Carter Blvd.  
MD 4204  
Fort Worth, TX 76155

Robert J. Uhrich  
Director of Air Service Development  
**Savannah Airport Commission**  
400 Airways Avenue  
Savannah, GA 31408

**Sound Technologies**  
c/o Joanne W. Young  
Baker & Hostetler LLP  
1050 Connecticut Ave, N.W.  
Suite 1100  
Washington, DC 20036

Robert W. Kneisley  
Associate General Counsel  
**Southwest Airlines Co.**  
1250 Eye Street, N.W.  
Suite 1110  
Washington, DC 20005

**TACA International Airlines**  
c/o John R. Brimsek  
Mullenhoz, Brimsek & Belair  
1150 Connecticut Avenue, N.W.  
Suite 700  
Washington, DC 20036

George J. Aste  
Vice President-  
International Affairs  
**Trans World Airlines, Inc.**  
900 19th Street, N.W.  
Suite 350  
Washington, DC 20006

Andrew B. Steinberg  
Executive Vice President  
Keenan M. Conder  
Associate General Counsel  
**Travelocity.com**  
1600 Trinity Blvd.  
Fort Worth, TX 76155

**United Airlines**  
c/o Bruce Rabinovitz  
Jeffrey A. Manley  
Wilmer, Cutler & Pickering  
2445 M Street, N.W.  
Washington, DC 20037

Bruce Bishins  
President and CEO  
**United States Travel Agent Registry**  
511 Avenue of the Americas  
New York, NY 10011

**US Airways**  
c/o Donald T. Bliss  
O'Melveny & Myers LLP  
555 13th Street, N.W.  
Suite 500 West  
Washington, DC 20004

**Varig Brazilian Airlines**  
c/o Constance O'Keefe  
Boros & Garofalo  
1201 Connecticut Avenue, N.W.  
Suite 550  
Washington, DC 20036

**Virgin Atlantic Airways**  
c/o Jeffrey N. Shane  
Hogan & Hartson  
555 13<sup>th</sup> Street, N.W.  
Washington, DC 20004

Glenn P. Wicks  
**The Wicks Group, Inc.**  
1700 North Moore Street  
Suite 1650  
Arlington, VA 22209

**Woodside Travel Trust**  
c/o Edward P. Faberman  
Michelle M. Faust  
Ungaretti & Harris  
1500 K Street  
Suite 250  
Washington, DC 20005

**Worldspan**  
c/o Charles J. Simpson  
Craig M. Cibak  
Zuckert, Scoutt & Rasenberger  
888 17<sup>th</sup> Street, N.W.  
Suite 600  
Washington, DC 20006

  
Joel A. Silversmith